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In the Supreme Court of the United States

OCTOBER TERM, 1991

CHARLES M. ZARZECKI, PETITIONER

v.

UNITED STATES OF AMERICA, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether it violates Section 10(b) of the Securities Exchange Act of 1934 to enter into bona fide arm's-length trades of securities on the open market, without any of the customary indicia of fraud such as misrepresentation or violation of a special duty of disclosure, solely because the trader hopes to affect the price of the securities by his transactions.

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OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-21a) is reported at 937 F.2d 823. An opinion amending that opinion in certain respects (App., *infra*, 52a-54a) is reported at 946 F.2d 188. The post-trial opinion of the district court (App., *infra*, 22a-49a) is reported at 726 F. Supp. 447. Prior opinions of the court of appeals and district court, not relevant to the issue presented by this petition, are reported at 858 F.2d 115, 713 F. Supp. 629, 706 F. Supp. 1102, and 699 F. Supp. 36.

JURISDICTION

The court of appeals entered its judgment on June 28, 1991. The court of appeals denied petitioner Zarzecki's petition for rehearing on October 2, 1991 (App., *infra*, 50a-51a) and partially granted a petition for rehearing filed by other defendants on October 9, 1991 (App., *infra*, 52a-54a). On December 9, 1991, Justice Thomas extended the time within which to petition for a writ of certiorari to and including January 30, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT

Petitioner was convicted by a jury in the United States District Court for the Southern District of New York of four counts of wire fraud (counts 48 to 51), two counts

of securities fraud (counts 52 and 53), one count of conspiracy to commit securities fraud (count 1),[1] and certain other counts, not relevant here, that were reversed on appeal and will not be retried. He was also acquitted of one count of securities fraud (count 54). The court of appeals affirmed in pertinent part. As the court of appeals recognized by discussing all of the convictions at issue here under the single heading "securities fraud" (App., *infra*, 11a-13a), none of petitioner's various interrelated convictions can stand unless he committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

This petition for a writ of certiorari challenges petitioner's convictions on one simple basis that cuts across all of the relevant counts: what petitioner did is not a crime. There is no dispute whatever about the relevant facts insofar as they concern the *conduct* (as opposed to the intention) of petitioner and others. Furthermore, although petitioner continues to deny that he acted with the intention to lower the price of the stock he is charged with having attempted to manipulate, we assume for purposes of this petition that an adequately supported contrary finding was made below. This petition thus presents a simple question of law: whether one who enters into bona fide arm's-length trades of securities on the open market, without any of the customary indicia of fraud such as misrepresentation or violation of a special duty of disclosure, commits securities fraud prohibited by Section 10(b) and Rule 10b-5 merely because he hopes to affect the price of the securities by his transactions. The answer to that question will determine whether a wide variety of commonplace trading activities, heretofore assumed to be perfectly innocent, can be subjected to criminal sanctions.

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[1] The charged conspiracy had several alleged objects, including tax fraud, but the only object that survived the court of appeals' decision was securities fraud.

A. The Undisputed Facts

1. In March 1985, Drexel Burnham Lambert, Inc., was retained to underwrite a $25 million convertible bond offering for C.O.M.B. Co. (COMB). The attractiveness of a convertible bond to the investing public depends on its interest rate, the price at which the bond can be converted into common stock, and the price of the common stock at the time of the offering. In that regard, the issuer and the investing public have adverse interests: the higher the stock price at the time of the offering, the more the issuer is able to raise the price of the bonds or the conversion price or lower the interest rate; the lower the contemporaneous stock price, the less attractive any particular bond offering is.

For that reason, as the court of appeals and the government readily acknowledged, issuers "in some cases[] attempt to 'levitate' the price into a higher range." App., *infra*, 11a. In this case, the price of COMB stock rose some 19%, from 13½ to an all-time high of 16, between March 1 and April 11, 1985; much of that rise—from 15⅜ to 16—occurred between the opening of trading on April 11 and 12:10 p.m. that day. C.A. App. 1396-1405, 1417-1418, 1606. It is undisputed that Drexel believed "that C.O.M.B. was 'levitating' the price of its stock" above the stock's true value. App., *infra*, 12a.

Drexel's responsibility as underwriter was that of a middleman serving *both* the issuer and the investing public. C.A. App. 3104/27, 3104/33-34. In this case, Drexel is alleged to have tried (without success) to lower the price of COMB stock from what it believed to be its artificially high, levitated level. If levitation had indeed occurred, the effect of the alleged action would be to *protect the investing public* from buying bonds based on an artificially inflated view of the "true" worth of COMB stock.

Petitioner's co-defendant Bruce Newberg was a bond trader for Drexel. Petitioner was the head trader at Princeton Newport Partners, L.P., whose 20-year-old investment strategy was to buy convertible bonds to "hedge"

short sales of common stock. C.A. App. 2667-2670. Newberg called petitioner at 12:23 p.m. on April 11, 1985, and informed petitioner of his belief that the stock was overvalued at 16. Newberg added, "I want it down to at least 15¾, and hopefully lower," and he suggested that he would like petitioner to sell some COMB stock. C.A. App. 1597.

Petitioner, acting consistently with Princeton Newport's longstanding investment strategy, did what any smart investor would do if he believed a stock was overvalued: he sold the stock short at the highest price he could obtain. First, he sold 10,000 shares directly to Jefferies & Co., the "market maker" in the stock, at 16. C.A. App. 1606. Second, he used a broker to represent Princeton Newport in the sale of 30,000 more shares to Jefferies at 16 without disclosing to Jefferies that Princeton Newport was the seller. C.A. App. 1609-1617. Third, he *declined* Jefferies' unsolicited offer to buy more stock at 16 and instead suggested that he might be willing to sell at an unspecified *higher* price. C.A. App. 1395, 1619. These transactions (and telephone calls discussing them) constitute, in their entirety, petitioner's "crimes."

All of those dealings with Jefferies had been concluded by the time petitioner called Newberg at 1:27 p.m. Petitioner told Newberg that the price of COMB had not dropped. Nevertheless, Newberg did not urge petitioner to make additional sales. C.A. App. 1620-1621.

The stock was still trading at 16 when petitioner called Newberg at 2:21 p.m. and again a few minutes later. No trades were made as a result of these calls, although Newberg expressed a desire to "hit 'em again" if the price rose. Newberg also expressed approval of petitioner's having dealt with Jefferies through a broker rather than directly. Immediately after petitioner said that he had used a broker "so they [Jefferies & Co.] didn't know it was us," Newberg said, "that was good" and, laughing, called petitioner a "sleaze." C.A. App. 1623, 1626-1627. The entire conversation had to do

with petitioner's decision to use a broker for the sale of 30,000 out of 40,000 shares; no mention was made of any effort to affect the price of the stock.

The price of COMB stock dropped slightly below 16 for the first time at 2:38 p.m. C.A. App. 1419. It had risen back to 16 by Monday, April 15, the next time Princeton Newport sold any shares of the stock. C.A. App. 1396-1405. (This trade was the subject of the count on which the jury acquitted petitioner. See App., *infra*, 23a.) After a series of further transactions never alleged to be tainted in any way, including the purchase of enough bonds in the public offering to cover the short sales (C.A. App. 1420), Princeton Newport netted a profit of $6,650 on its dealings in COMB stock. Tr. 3555. As the district court specifically found, "there was no evidence of market dislocation or any resultant investor harm." App., *infra*, 48a.

B. Judicial Proceedings

1. The government brought a massive indictment against petitioner, Newberg, and four co-defendants alleging, amidst numerous other tax-related and RICO charges in which petitioner was at most peripherally involved, that the foregoing activities constituted securities fraud, wire fraud, and conspiracy. The government did not allege that petitioner profited by selling securities to Jefferies at a *higher* price than he could have obtained if he had made some legally required disclosure,[2] or even that he or anyone else profited by trading securities at an artificially manipulated price. Nor did it allege that petitioner's trades were fictitious (*i.e.*, that through matched orders, wash sales, or some other device petitioner transferred securities without changing beneficial ownership and thus failed to place his

[2] "[T]here was no evidence at all in this case concerning allegations of insider trading." Gov't C.A. Br. 137. "[A]n insider trading theory * * * was not pressed by the Government or otherwise supported by any evidence." *Ibid.*

own capital at risk). Instead, the government alleged that petitioner and Newberg "engaged through subterfuge in manipulation" (C.A. App. 240, ¶ 24) in "an attempt to drive the stock price down" (C.A. App. 242, ¶ 28).

The government's theory, as the briefing on appeal eventually made clear, is that petitioner's *intent* alone sufficed to make his otherwise lawful conduct a crime. The indictment did make a passing nod at trying to fit this case within more conventional theories of securities law by alleging that petitioner was guilty of a failure to disclose. But the allegation amounted to little more than a charge that petitioner used a broker: in this respect, the indictment identified as petitioner's "crime" his failure to disclose to Jefferies Drexel's "involvement" in the COMB sales and Princeton Newport's identity as the seller of 30,000 of the 40,000 shares. C.A. App. 242, ¶ 29. The indictment did *not* allege, however, that petitioner (or even Drexel) stood in any fiduciary or similar relation of trust and confidence to Jefferies that would give rise to a *duty* to disclose *anything* to Jefferies.

Over defendants' objection (C.A. App. 911, 5003), the district court instructed the jury in the general terms of Rule 10b-5 (C.A. App. 4235, 4262-4263). To learn what facts were allegedly concealed and from whom, the jury was forced to refer to the language in the indictment regarding nondisclosures to Jefferies. Citing *Chiarella* v. *United States*, 445 U.S. 222, 228 (1980), the defendants specifically objected that the instructions would allow a conviction based on nondisclosures to a party with whom the defendant had no "fiduciary or other similar relation of trust or confidence." By special verdict, the jury acquitted petitioner of violating subsection (b) of Rule 10b-5 (false or misleading statements) but convicted him under the nondisclosure provisions of the Rule (subsections (a) and (c)). C.A. App. 4350-27 to 4350-29.

2. On appeal, petitioner renewed his argument that he had been convicted of something that simply "was not a

crime." C.A. Br. 2. The central issue on appeal became whether *Chiarella* applies to stock "manipulation" cases. Citing *Chiarella* and *Schreiber* v. *Burlington Northern, Inc.*, 472 U.S. 1 (1985), in which this Court said that the term "manipulative" in the securities laws is "directed at failures to disclose" (*id.* at 8), petitioner specifically argued that it was error to predicate his convictions on breach of a duty to make disclosures to Jefferies when there was no relationship that would give rise to any such duty. The government responded that, because petitioner was convicted on a "manipulation" rather than "insider trading" theory, duties of disclosure had nothing to do with this case except in the circular sense that "manipulative practices *themselves* give rise to liability, absent disclosure of the manipulation to the entire market." Gov't C.A. Br. 136 (emphasis in original). The government specifically argued that "[t]he fiduciary concept announced in *Chiarella* * * * is relevant to cases where the defendant is accused of trading on the basis of material nonpublic information, and *has no applicability where, as here, the gravamen of the charge is market manipulation.*" *Id.* at 137 (emphasis added). In its statement of facts (*id.* at 37-38), but nowhere in its argument (*id.* at 135-142), the government alluded to the theory of the indictment that using a broker to effect securities trades, and thereby failing to disclose a trader's identity, is a crime.

The court of appeals, in describing the facts, cited with apparent approval "[t]he Government's contention" that petitioner committed a crime by trading "without disclosing to [Jefferies] that PN was the seller or that Drexel was the moving party behind the entire deal." App., *infra*, 12a. It then affirmed the relevant convictions in a single paragraph. Although petitioner did nothing more than sell stock on the market, the court of appeals equated his conduct with an "ingenious device[]," brushed aside *Chiarella*, and completely ignored *Schreiber*:

> In enacting section 10(b), "Congress meant to prohibit the full range of ingenious devices that

> might be used to manipulate securities prices." *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 * * * (1977). For an informative discussion of the diverse devices that ingenious minds have conceived, see 3 Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud* § 7.3(220)-(227). The plan conceived by Newberg and [petitioner] fits comfortably within this "full range" of wrongful acts. *See, e.g., Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 792-93 (2d Cir.1969), *cert. denied*, 400 U.S. 822 (1970). "Failure to disclose that market prices are being artificially depressed operates as a deceit on the market place and is an omission of a material fact." *United States* v. *Charnay*, 537 F.2d 341, 351 (9th Cir.), *cert. denied*, 429 U.S. 1000 * * * (1976). *Appellants' argument that a fiduciary relationship must exist before liability can be found is without merit. The case of* Chiarella v. United States * * * *upon which appellants rely involved trading on the basis of nonpublic information; here, appellants are charged with market manipulation.* In sum, Newberg's and [petitioner]'s convictions on the counts charging market manipulation in connection with the C.O.M.B. offering must be affirmed.

App., *infra*, 12a-13a (emphasis added).

3. Twelve days after deciding this case, the same court of appeals decided *United States* v. *Mulheren*, 938 F.2d 364 (2d Cir. 1991). Like petitioner, Mulheren was prosecuted and, at the trial level, convicted of securities fraud solely on the basis of his alleged intent to affect prices by an open-market transaction, without any claim by the government that he was a fiduciary or an insider who owed anyone any duty other than the circular duty of "disclosure of an intent to manipulate." *Id.* at 368 n.2. The court in *Mulheren* "harbor[ed] doubts about the government's theory of prosecution" (*id.* at 366) and expressed "misgivings about the government's view of the law" (*id.* at 368) but did not have to resolve the issue because the evidence failed to support a finding that Mulheren acted with the intent to affect price rather than the intent to invest. Although petitioner was convicted

under the same theory that so troubled the *Mulheren* panel, the court of appeals denied rehearing and rehearing en banc.[3]

REASONS FOR GRANTING THE PETITION

"Recent events have dramatically increased interest in the concept of manipulation in financial markets." Fischel & Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 HARV. L. REV. 503, 505 (1991). Accompanying (or, in part, causing) the dramatically increased interest in this subject has been the dramatically increased zeal of federal prosecutors to extend the criminal sanction of the securities laws far beyond its traditional ambit. The government has now taken to prosecuting, as alleged "manipulators," persons who have spread no false rumors, engaged in no fictitious transactions, and committed no frauds, solely because their purchases or sales of stock do not conform to some economists' conception of why people buy and sell securities.[4]

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[3] We do *not* urge an intracircuit "conflict" as a basis for granting certiorari, in light of this Court's past pronouncements on the irrelevance of intracircuit conflicts and the failure of the *Mulheren* panel to resolve its doubts one way or the other. Nevertheless, *Mulheren* is instructive here for two reasons. First, along with other factors discussed below, it helps to demonstrate the tenuousness and broad reach of the government's theory. Second, "reasonable doubt * * * about a statute's intended scope" after appropriately careful inquiry is *itself* sufficient reason to reverse a criminal conviction under the rule of lenity. *Moskal* v. *United States*, 111 S. Ct. 461, 465 (1990). The doubts that the Second Circuit expressed in *Mulheren* about the government's radical new theory of securities fraud, which criminalizes "bad" intent alone, are certainly reasonable enough to justify invocation of this principle, particularly because it would be "extraordinary" to hold that a "criminal statute is violated if and when its purposes seem to be offended." *Crandon* v. *United States*, 494 U.S. 152, 180 (1990) (Scalia, J., concurring in the judgment); see also *id.* at 160 (majority opinion) ("it is rare that legislative history or statutory policies will support a construction of a [criminal] statute broader than that clearly warranted by the text").

[4] The statement in the text is not hyperbole. An example of the lengths to which the government is willing to push its theory comes

No law has heretofore been thought to make such conduct criminal, and it is not surprising that the recent efforts to expand the scope of Section 10(b) and related provisions of the securities laws have, for the most part, been rebuffed. See Fischel & Ross, *supra*, 105 HARV. L. REV. at 527-534 (discussing three recent cases, two of them reversals of criminal convictions and all, in the authors' view, involving conduct at least as consistent with innocent explanations as with a theory of manipulation). In this case, however, the court of appeals did not rebuff the prosecutor but instead placed its imprimatur on what is perhaps the most radical expansion of the reach of Section 10(b) to have been proposed by prosecuting authorities to the federal courts. This Court's review is warranted in view of the primacy of the Second Circuit in this area of the law, the Second Circuit's patent misunderstanding of this Court's decisions concerning stock market "manipulation," and the potential of the decision below to criminalize conduct that is commonplace and traditionally considered entirely proper.

A. Petitioner's Conduct Was Not A Crime

1. Section 10(b) prohibits "any manipulative or deceptive device or contrivance in contravention of" SEC rules. As Rule 10b-5 makes clear, devices are "manipulative or deceptive" under that provision only if they are part of a scheme to defraud others. Thus, this Court has made

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from its brief (at 37 n.*) in *United States* v. *Mulheren*, 938 F.2d 364 (2d Cir. 1991) (No. 90-1691) (emphasis added):

> Mulheren's suggestion that he would not be guilty of securities fraud if he awakened one morning and decided to raise the price of Gulf and Western stock one quarter of a point [by open-market purchases of a sufficient quantity of the stock] because it was his wife's 45th birthday * * * confuses motive with intent. *He would indeed be guilty*, just as he would be guilty of a bank robbery if he awoke one morning and tried to rob a bank on 45th Street because it was his wife's 45th birthday. *By effecting transactions for the purpose of rigging the price of a publicly traded security, Mulheren acted to deceive and is guilty of securities fraud.*

it clear that these provisions are not violated unless the defendant has engaged in some form of deception. See *Schreiber* v. *Burlington Northern, Inc.*, 472 U.S. 1, 7-8, 12 (1985); *Chiarella* v. *United States*, 445 U.S. 222, 225-235 (1980); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 154 (1972); Fischel & Ross, *supra*, 105 HARV. L. REV. at 511 n.33 ("[t]he Supreme Court in recent years has held that the term manipulation under the securities laws requires deception"); Thel, *Regulation of Manipulation Under Section 10(b): Securities Prices and the Text of the Securities Exchange Act of 1934*, 1988 COLUM. BUS. L. REV. 359, 388 ("*Schreiber* unquestionably defines the term 'manipulative' for the purposes of section 10(b)," and "nothing is manipulative unless it is deceptive"). Deception, in turn, requires that the defendant either misrepresented a material fact or failed to disclose a material fact that he was under a duty to disclose in connection with the purchase or sale of securities. See *Schreiber*, 472 U.S. at 7-8, 12; *Affiliated Ute Citizens*, 406 U.S. at 154. Here, the jury acquitted petitioner of misrepresentation, so the only issue is culpable nondisclosure.

In view of the Second Circuit's holding in this case, it is important for this Court now to reconfirm that the requirement of culpable nondisclosure (or misrepresentation) applies to price manipulation with the same force as it does to other methods of violating Section 10(b). That is, a manipulation is not a violation of Rule 10b-5, and therefore of Section 10(b), unless it is effected by means of the kind of deceitful or dishonest conduct that characterizes fraud. See *Chiarella*, 445 U.S. at 234-235 ("Section 10(b) is aptly described as a catchall provision, but what it catches must be *fraud*") (emphasis added). This Court confirmed that view in *Schreiber*, 472 U.S. at 12-13, holding that, even if an activity affects the market price of a stock, it is not unlawful manipulation unless there is a misrepresentation or a breach of a duty to disclose. Although that case was decided under Section 14(e) of the Securities Exchange Act, 15 U.S.C. § 78n(e), the Court held that claims under both that provision

and Section 10(b) require proof of a misrepresentation or violation of a duty of disclosure. The Court explained (472 U.S. at 7-8 (footnote omitted)):

> [W]e have interpreted "manipulative" in [10b-5 cases] to require misrepresentation. * * * All three species of misconduct, *i.e.*, "fraudulent, deceptive, or manipulative," listed by Congress are directed at failure to disclose. The use of the term "manipulative" provides emphasis and guidance to those who must determine which types of acts are reached by the statute; it does not suggest a deviation from the section's facial and primary concern with disclosure or congressional concern with disclosure which is the core of the Act.[5]

Thus, it is hardly surprising that recent commentary, in sharp contrast to the Second Circuit's opinion here deeming *Chiarella* irrelevant in a manipulation case (App., *infra*, 13a), has without hesitation cited *Chiarella* in the manipulation context for the proposition that, "[a]bsent a fiduciary relationship or other special circumstance, traders do not have a duty to disclose the information they possess that motivates their trades." Fischel & Ross, *supra*, 105 HARV. L. REV. at 509 & n.29; see also *id.* at 512 & n.36; Thel, *supra*, 1988 COLUM. BUS. L. REV. at 405 & n.204 (in order to prevent manipulation, "the SEC

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[5] See also Mathews, Levine, Citera & Dana, *Manipulative Practices: Past, Present and Future in* TRADING PRACTICES, THE PORTFOLIO EXECUTION PROCESS, AND SOFT DOLLAR PRACTICES 1990, at 97, 102-103 (Practising Law Institute Corporate Law and Practice Course Handbook Series No. 684, 1990) (recognizing that in *Schreiber*, "the Court held that 'manipulative' acts under Section 14(e) require misrepresentation or non-disclosure"); Thel, *supra*, 1988 COLUM. BUS. L. REV. at 388 n.119 ("*Schreiber* has been read to remove any doubt that misrepresentation or nondisclosure is an element of manipulation under § 10(b) of the Act"); Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. Miami L. Rev. 671, 682 (1986) (this Court in *Schreiber* "ma[de] it clear that misrepresentation or nondisclosure is *always* required in order to make out a case of manipulation") (emphasis in original); *id.* at 715.

might require traders to identify themselves if their trading practices would otherwise likely be misinterpreted by investors," but this Court in *Chiarella* "has foreclosed even this approach").

It is a sufficient basis to justify this Court's review that the Second Circuit has held (as the government specifically urged it to) that *Chiarella* is irrelevant in a "manipulation" case. This Court has *already* made it clear in *Schreiber* that "manipulation" is but one species of the deceptive conduct that is at the heart of the concept of fraud. Because there is no issue of misrepresentation in this case (petitioner was acquitted of misrepresentation) and *Chiarella* is the governing case specifying when a duty to disclose arises, it follows that—as commentators understand—*Chiarella* applies to manipulation cases with the same force as to other cases prosecuted under Section 10(b). Certiorari should be granted to resolve the uncertainties created by the Second Circuit's rejection of the principles laid down in *Schreiber* and *Chiarella* regarding the character of manipulation as a form of fraud.

2. Under a proper view of the reach of Section 10(b), petitioner committed no crime. He was specifically acquitted of misrepresentation (of which there was indeed no evidence), and there is no evidence that he sought to dominate the market, control the supply of COMB stock, engage in "wash" sales or "matched" orders, spread misleading information to induce sales by others, make fictitious quotes, pay touts to recommend the stock, or engage in any of the other deceptive activities identified in other cases where unlawful manipulation has been found.[6] He

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[6] Nearly all the cases that have found manipulation under Section 10(b) have involved some form of deceptive conduct aimed at misleading the public. See, *e.g.*, *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 792-798 (2d Cir. 1969) (in an attempt to block a takeover by a third party of a company with which it wished to merge, the defendant made massive purchases of the company's stock, driving the price above what it would otherwise have been,

merely sold stock. Although the government claims that he did so with the hope that his sales would induce a drop in its price, trading with such a hope is not deception. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 437 ("if the word deceptive is construed to include disruptive trading, it is being given a much broader construction than the Court, or for that matter almost anyone else, has given it").

"Before liability, civil or criminal, may be imposed for a Rule 10b-5 violation, it is necessary to identify the duty that the defendant has breached." *Chiarella*, 445 U.S. at 237 (Stevens, J., concurring). Yet the court of appeals did not suggest that petitioner failed to disclose any material fact that he was under a duty to disclose in connection with a sale or purchase of securities. The

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while simultaneously selling those securities at lower prices for a substantial loss in secret and unreported sales), cert. denied, 400 U.S. 822 (1970); *United States* v. *Scop*, 846 F.2d 135, 137 (defendants, seeking to promote public offering of new stock, engaged in matched orders through fictitious nominees), modified on other grounds, 856 F.2d 5 (2d Cir. 1988); *United States* v. *Gilbert*, 668 F.2d 94, 95 (2d Cir. 1981) (defendant "manipulated the price increase through an elaborate series of wash sales and matched orders" to make profits for himself and the accounts he controlled), cert. denied, 456 U.S. 946 (1982); *SEC* v. *Resch-Cassin & Co.*, 362 F. Supp. 964, 978 (S.D.N.Y. 1973) (defendants paid brokers to quote the security and manipulated the supply of the stock).

Deceptive conduct is also the hallmark of manipulation cases under Section 9(a)(2) of the Securities Exchange Act, 15 U.S.C. § 78i(a)(2). See, *e.g.*, *United States* v. *Projansky*, 465 F.2d 123 (2d Cir.) (promoters of stock paid brokers to recommend and to buy the stock for their customers), cert. denied, 409 U.S. 1006 (1972); *United States* v. *Stein*, 456 F.2d 844 (2d Cir.) (defendants offered brokers secret compensation to induce them to promote sales of the stock), cert. denied, 408 U.S. 922 (1972); *United States* v. *Minuse*, 114 F.2d 36, 38 (2d Cir. 1940) (market manipulated by use of dummy accounts, guaranteeing purchasers against loss, using wash and matched sales, making payments to brokers to advise customers to purchase the stock, and disseminating misleading bullish literature); *R.J. Koeppe & Co.* v. *SEC*, 95 F.2d 550, 552 (7th Cir. 1938) (company compensated an individual to "tout" the stock).

court did, in passing, seem to approve the theory of the indictment in this case that the element of misrepresentation or wrongful nondisclosure is satisfied here by petitioner's use of a broker to disguise from Jefferies the fact that Princeton Newport was a principal in the second sale transaction. App., *infra*, 12a. But, far from being a virtue of the government's case, the possibility that petitioner was convicted for using a broker to conceal his identity is a serious vice with highly disturbing ramifications for securities trading. Use of brokers to conceal the identity of a principal is, to put it mildly, an everyday occurrence in the nation's securities markets—one that no one could have dreamed, before this prosecution, exposed the principal to the risk of a fraud prosecution. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 405 & n.204. Furthermore, there was not (and was not even alleged to be) any fiduciary or similar relationship that would give rise to a duty to disclose petitioner's or Drexel's identity to the stock purchaser. Thus, the government did not even defend this theory on appeal.

For its part, the government's only nondisclosure argument was that petitioner had a general obligation to disclose his subjective intent: "manipulative practices *themselves* give rise to liability, absent disclosure of the manipulation to the entire market." Gov't C.A. Br. 136 (emphasis in original). The law, however, does not support that premise. Given that the government expressly disclaimed any theory that petitioner was either a fiduciary or an insider (see note 2, *supra*), it is clear that he had no duty to disclose any facts to others—even material ones. As this Court explained in *Chiarella* in holding that an employee of a financial printer had no duty to disclose material nonpublic information in his possession before making purchases based on that information:

> [O]ne who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to

> know because of a fiduciary or other similar relationship of trust and confidence between them." * * * Accordingly, a purchaser [or seller] of stock who has no duty to a prospective seller [purchaser] because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts.

445 U.S. at 228-229 (footnote omitted); accord *Dirks* v. *SEC*, 463 U.S. 646, 654-655 (1983); *Deutschmann* v. *Beneficial Corp.*, 841 F.2d 502, 506 (3d Cir. 1988) ("[m]arket participants who are neither insiders nor fiduciaries of another type need not disclose material facts"), cert. denied, 490 U.S. 1114 (1989).[7]

Moreover, even if petitioner had a duty to disclose material facts to others, that duty would not extend to his motive in selling COMB stock.[8] Numerous courts

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[7] By contrast, most cases finding manipulation under Section 10(b) or under Section 9(a)(2) of the Securities Exchange Act, 15 U.S.C. § 78i(a)(2), involve representatives of the company or issuers of stock who *do* owe a special duty to investors. See, *e.g.*, *Pagel, Inc.* v. *SEC*, 803 F.2d 942, 946 (8th Cir. 1986) (defendants were underwriters of the stock); *Alabama Farm Bureau Mutual Casualty Co.* v. *American Fidelity Life Insurance Co.*, 606 F.2d 602, 608 (5th Cir. 1979) (defendants were corporate directors and officers), cert. denied, 449 U.S. 820 (1980); *United States* v. *Projansky*, 465 F.2d 123 (2d Cir.) (defendants were promoters of the stock), cert. denied, 409 U.S. 1006 (1972); *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546-547 (2d Cir. 1967) (majority stockholder manipulated stock to deceive minority shareholders); *United States* v. *Minuse*, 114 F.2d 36, 38 (2d Cir. 1940) (defendant company manipulated market of its own stock); *R.J. Koeppe & Co.* v. *SEC*, 95 F.2d 550, 552 (7th Cir. 1938) (company compensated an individual to "tout" the stock). The possibly contrary decision in *United States* v. *Charnay*, 537 F.2d 341 (9th Cir.), cert. denied, 429 U.S. 1000 (1976), on which the court of appeals here relied (App., *infra*, 12a-13a), antedates *Chiarella*, *Dirks*, and *Schreiber* and cannot be regarded, after those decisions, as valid authority for the proposition that a duty of disclosure arises in the absence of a fiduciary or other special relationship.

[8] As one commentator has put it in discussing a case in which traders consented to an injunction under Section 10(b) and Rule 10b-5:

have held that there is no general duty to disclose one's subjective motivation for engaging in securities transactions. This Court, for example, one day before the decision below, wrote that "disbelief or undisclosed motivation, standing alone, [is] insufficient to satisfy the element of fact that must be established" in litigation under the securities laws. *Virginia Bankshares, Inc.* v. *Sandberg*, 111 S. Ct. 2749, 2760 (1991).[9]

There is nothing special about manipulation cases that would justify the imposition of a duty to disclose subjective motivations. Even if it is true that members of the investing public might find the alleged manipulator's subjective motivation "material" to their investment decisions, that is true as well in many other situations in which it is plain that the securities laws impose

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> The SEC overreached if section 10(b) only reaches deceptive devices and contrivances. The traders purposefully distorted market prices, but even if that is reprehensible it is not deceptive. They did not represent that in trading they were motivated by normal supply and demand. *Nor were people reading the reports of the trades entitled to assume that the traders were so motivated, inasmuch as the law neither requires traders to disclose their motivations nor makes it illegal to trade for the purpose of changing prices.*

Thel, *supra*, 1988 COLUM. BUS. L. REV. at 419-420 (footnote omitted; emphasis added). Petitioner stands *criminally* convicted for doing exactly what this commentator says is not illegal and for failing to disclose exactly what the commentator says he is not required to disclose.

[9] The Court was considering specifically Section 14(a) of the Act, 15 U.S.C. § 78n(a), but it reached its conclusion by relying in large part on Section 10(b) precedent condemning "litigation confined solely to what one skeptical court spoke of as the 'impurities' of a director's 'unclean heart.'" 111 S. Ct. at 2760 (quoting *Stedman* v. *Storer*, 308 F. Supp. 881, 887 (S.D.N.Y. 1969)). See also *Field* v. *Trump*, 850 F.2d 938, 947 (2d Cir. 1988), cert. denied, 489 U.S. 1012 (1989); *Ward* v. *Succession of Freeman*, 854 F.2d 780, 791 (5th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Kas* v. *Financial General Bankshares, Inc.*, 796 F.2d 508, 513-515 (D.C. Cir. 1986); *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 288 (7th Cir.), cert. denied, 454 U.S. 1092 (1981); *Golub* v. *PPD Corp.*, 576 F.2d 759, 765 (8th Cir. 1978).

no disclosure duty. For example, investors might find it material that a large purchase of stock was based on mere speculation or on the application of an especially powerful new formula for measuring the likely price movement of a security. Surely they would find it material also, as in *Chiarella*, to know that the purchaser of stock had information that the company was a takeover target. Indeed, there is no limit to the reasons for past purchases and sales of stock that subsequent investors might find it useful to know in assessing the value of the stock. There is simply no basis in law or policy, however, for imposing a duty to disclose those subjective motivations. The decision below, by finding culpable nondisclosure in a case where the *only* thing that was not disclosed was subjective motivations, has frightening implications for honest participants in the securities markets.

3. The weakness of the government's theory is highlighted by its inability even to identify the parties to whom petitioner owed a duty to disclose his subjective motivations. The government has never alleged that petitioner owed such a duty to COMB; it has, at various times, alleged that petitioner owed duties either to the market at large or to Jefferies. Neither theory works.

On appeal, the government relied on a duty of "disclosure of the manipulation *to the entire market*." Gov't C.A. Br. 136 (emphasis added). That argument should be recognized for the bootstrapping that it is. First, the kind of disclosure that the government suggests would suffice to allow a trader to act with the intent to affect prices is one that does not exist in the real world. Although a trader like petitioner, acting with the intent to move prices *closer* to what he perceives as their "true" level, might disclose the factual basis for his belief that the stock is misvalued (here, COMB's perceived "levitation" scheme), that kind of disclosure would actually move the prices in the direction that the alleged "manipulator" desires and would therefore *further* rather than defeat what the government perceives here as a crime:

"an attempt to drive the stock price down." C.A. App. 240, ¶ 28. What the government must be demanding, therefore, is not a disclosure of that sort but rather some kind of self-defeating disclosure ("Don't take my act of selling this stock as implying anything about what I truly think the stock is worth, because I'm actually just trying to depress its price."). Because such a disclosure would be a complete absurdity (and, incidentally, far more misleading than anything petitioner actually did), what the government is really saying is that the intent to affect stock prices is the crime in and of itself. But, as we have shown, there can be no violation of Section 10(b) in the absence of a misrepresentation or breach of a duty of disclosure.

Second, at least in the absence of specific statutory duties imposed by the securities laws on persons such as issuers and underwriters, a duty to make a disclosure "to the entire market" is unknown to the law. This Court has twice declined to "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties." *Dirks*, 463 U.S. at 666 n.27; *Chiarella*, 445 U.S. at 233; see also Thel, *supra*, 1988 COLUM. BUS. L. REV. at 437 n.331 ("there seems little predicate for requiring traders to concern themselves with the reactions of unrelated strangers with whom they do not propose to deal").[10]

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[10] Given that petitioner did not engage in any particular transaction that was itself fraudulent, the government's theory is apparently that petitioner committed a "fraud on the market" by attempting to cause other sellers of COMB stock to obtain less for the stock than it was worth. But, even aside from the fact that petitioner's alleged effort was to move the price of COMB stock *closer* to what he perceived as its "true" value, the fraud-on-the-market theory is completely inapposite in this context. That "theory has nothing to do with an affirmative duty to disclose material information." *Roeder* v. *Alpha Industries*, 814 F.2d 22, 27 (1st Cir. 1987). To the contrary, "[i]t only addresses the 'unreasonable and irrelevant evidentiary burden' of requiring plaintiffs in non-disclosure cases to prove reliance. * * * [It] does not dispense with the requirement that there must be a duty to disclose before there can be liability." *Ibid.* It would be particularly egregious to base *crim-*

The government cannot fare any better by postulating a duty of disclosure to Jefferies, the buyer. In the first place, "[a]s a general rule, neither party to an arm's-length business transaction has an obligation to disclose information to the other unless the parties stand in some confidential or fiduciary relation" (*Chiarella*, 445 U.S. at 239-240 (Burger, C.J., dissenting)), and the government has suggested no basis here to depart from that general rule. Furthermore, consider the disclosures that petitioner might have made to Jefferies. He might have said, "I am selling because I have been informed that COMB has been levitating the price of its stock," which presumably would have led Jefferies to pay a *lower* price for petitioner's shares—thus furthering the alleged scheme to depress the stock price. Or he might have said (contrary to his actual belief), "I'm offering to sell at a price I believe to be below the true value of the stock," which surely would have been immaterial to Jefferies' decision to buy. Section 10(b) does not require immaterial disclosures (see, *e.g.*, *Basic Inc.* v. *Levinson*, 485 U.S. 224, 232 (1988) (adopting a "standard of materiality for the § 10(b) and Rule 10b-5 context")), much less disclosures that would tend only to further the "scheme" that is said to violate the statute.[11]

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inal liability on the extremely controversial fraud-on-the-market theory, for to do so would be to penalize traders for doing nothing more than trying to move a stock's price away from (or, in this case, *toward*) its "true value." In addressing the fraud-on-the-market theory in its much milder form as a causation theory, two of the six participating Justices emphatically rejected the "suggest[ion] that stocks have some 'true value' that is measurable by a standard other than their market price" and added with approval that many investors purchase or sell precisely *because* they do not share the "presumption that a stock's price is a 'reflection of [this] value.'" *Basic, Inc.* v. *Levinson*, 485 U.S. 224, 255-256 (1988) (White, J., dissenting).

[11] Significantly, in this case the district court, over the defendants' objection, failed to instruct the jury that non-disclosures must be "material" in order for there to be a violation of the relevant subsections of Rule 10b-5. C.A. App. 4262-4264, 4303-4304, 4326-4327.

4. Unlawful manipulation of the price of a security is, virtually by definition, the artificial inflation or depression of its price so that the manipulator (or a confederate) may thereupon reap illicit profits by selling the security to or purchasing it from persons who do not know that the market price has been artificially altered. To this extent, we believe that we and the government would be in agreement. We part company, however, on the question whether it can ever be unlawful manipulation under Section 10(b) to seek to affect the price of a security by arm's-length trades on the open market—especially trades by non-insiders, unaccompanied by any misrepresentations.

The unsoundness of the government's theory, now adopted as the law of the Second Circuit, becomes clear when some of its hypothetical applications are examined. Consider, for example, the business school professor who, in order to show his or her students the way in which strategic trading can move the price of a stock, makes a carefully timed purchase or sale of the stock that demonstrates the theory. Under the decision below, such a trade would constitute criminal price manipulation of a security in violation of Section 10(b).

The reason that this result seems so wrong is that it divorces criminal liability from the danger that the prohibition against manipulation is designed to avoid—the *subsequent* purchase or sale at a manipulated price. This is why Section 9(a)(2), where manipulation is specifically defined, requires as an essential element that the manipulative activity be undertaken "for the purpose of inducing the purchase or sale of such securities by others." 15 U.S.C. § 78i(a)(2).[12] And that is why the

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Petitioner raised that issue on appeal (C.A. Br. 19, 22; C.A. Reply Br. 3-6, 9-10), but the court of appeals did not even mention the point in its opinion.

[12] See *Santa Fe Industries* v. *Green*, 430 U.S. 462, 476 (1977) (looking to Section 9(a)(2) for guidance in interpreting term "manipulative" under Section 10(b)); *Hundahl* v. *United Benefit*

duty to disclose, and any culpable nondisclosure, could arise only in connection with the purchase or sale at the manipulated price (and only on the part of persons such as issuers, underwriters, or other "insiders" who owe special duties to those with whom they trade). No duty arises at the time of the manipulative transaction itself.

Indeed, it is only at the time of a trade at an artificial price that any nondisclosure could become material. If the "manipulative" trade is a phony transaction between fellow manipulators, there is of course nothing to disclose. And if the trade is a bona fide market transaction with innocent third parties, the transaction enables them to buy at a lower price or sell at a higher price than the "real" value of the security; in such a case, the undisclosed manipulative purpose is immaterial to the third parties because they are its beneficiaries, and disclosure could not possibly alter their willingness to engage in the trade.

A proper understanding of the evil that the prohibition of manipulation addresses also helps to explain why arm's-length transactions on the open market cannot properly be deemed manipulative. The gains to be made by a seller such as petitioner from subsequently buying at a depressed price will ordinarily be wholly offset by the losses incurred from the sales made to drive the price to an artificially low level. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 418 n.249. The way real manipulators are able to profit from their improper activities is by engaging in *phony* transactions in which they are not at risk.[13] Nothing of that sort happened here.

Life Insurance Co., 465 F. Supp. 1349, 1361-1362 (N.D. Tex. 1979) ("the scope of manipulation in section 9 sheds light on its scope under section 10(b)," and "[l]egislative history supports the even narrower view that the manipulative conduct prohibited in section 10(b) is limited to the devices which section 9 bars").

[13] Another way of saying this is that arm's-length market trades cannot, by definition, be manipulative because their impact on price simply is not "artificial."

The government's theory of prosecution in this case has created a victimless crime—selling securities in arm's-length stock transactions with the purpose of affecting the price of the stock. The theory rests on a palpable misinterpretation of a few old (and possibly outdated) cases that support Professor Loss's statement that Section 10(b) is violated "when securities are in fact sold at manipulated prices without *disclosure* of the manipulation." 8 L. LOSS & J. SELIGMAN, SECURITIES REGULATION 3980 (3d ed. 1991) (emphasis in original). In those cases, an individual fails to disclose his *prior* manipulation to those to whom he *subsequently* sells the stock. See, *e.g.*, *SEC* v. *Barrett & Co.*, 9 S.E.C. 319, 329 (1941) ("when a security is sold 'at the market,' the failure to disclose to purchasers the fact that the market price has been artificially inflated by the sellers' manipulation is an omission to state a material fact and constitutes a fraud on the purchasers"). The *Barrett*-type cases are a far cry from criminalizing the *first* trade when that trade is a bona fide, arm's-length transaction between two parties who each know everything the other knows except the other's subjective motivation for entering into that very transaction. Such transactions are completely indistinguishable from market activity that is lawful under any theory, and they cause *no harm* to the market. See Fischel & Ross, *supra*, 105 HARV. L. REV. at 519.

Thus, the rule of criminal liability adopted by the Second Circuit in this case cuts unlawful manipulation entirely loose from its prior moorings. The Second Circuit's rule does not protect securities markets against real price manipulation. This Court should move promptly to rectify the court of appeals' radical and unfounded expansion of criminal liability for manipulation of the price of a security.

B. The Second Circuit's Opinion Potentially Criminalizes A Broad Range Of Innocent Conduct And Therefore Warrants Review By This Court

The Second Circuit—the court that will resolve most future cases involving charges of securities "manipulation"—has at least spoken clearly. An intent to affect securities prices is enough, in the absence of disclosure of that intent, to make actual trades of securities a crime, and "a fiduciary relationship [need not] exist." App., *infra*, 13a. That clear rule, however, is both wrong as a matter of law (as discussed above) and staggering in its implications.

The imposition of criminal liability for a seller's failure to disclose his mere subjective desire that his sales will decrease the stock's price would subject any party who engaged in large sales of stock to a substantial and unfair risk of criminal punishment. Given that the difference between *knowing* that a sale may decrease the stock's price and acting for the *purpose* of bringing about such a result is often a marginal one, sellers could never be certain that a jury would find the former, rather than the latter. Indeed, a seller could easily have both a purpose of trading for his own investment benefit and a purpose of lowering the price. This Court should reject the government's attempt to make criminal liability turn on so fine a line. Cf. *Dirks*, 463 U.S. at 658 n.17 (rejecting an expansive interpretation of the securities laws that would be "inherently imprecise, [because] imprecision prevents parties from ordering their actions in accord with legal requirements"); *Pinter* v. *Dahl*, 486 U.S. 622, 654 n.29 (1988) (warning against the "risks [of] overdeterring activities related to lawful securities sales" as a result of judicial creation of open-ended legal standards that "produce[] unpredictable results"); note 3, *supra*.

The logic of the decision below—and the position the government has unreservedly endorsed (see note 4, *supra*) —is that an investor would commit a crime if he awakened one morning and decided to sell a stock, which he

believed to be overvalued, just because as a matter of whimsy he wanted to see if he could lower the stock's value; or if, to honor his daughter's 16th birthday, he tried to buy enough of the stock of a company she might be interested in to move its price up to exactly 16; or if, to express his displeasure with a company's product, he tried to sell enough of its stock to reduce its price. A wealthy eccentric who likes a company's new advertising jingle, and responds by setting out to buy enough of that company's stock to raise its price, has committed a crime under the Second Circuit's analysis. Indeed, a "socially responsible" mutual fund, pension fund, or institutional investor (such as a university) that decided to make a statement about companies that do business with South Africa, by selling off their stock and causing it to decline in value, would commit a crime by "artificially depress-[ing]" (App., *infra*, 12a) market prices, unless perhaps it saved itself by announcing its intentions not just to a limited community (such as its investors, beneficiaries, or students) but instead to "the entire market" (Gov't C.A. Br. 136).

Those are peculiar and unwarranted results. They stand in derogation of this Court's statement that "Section 10(b) is aptly described as a catchall provision, but what it catches must be *fraud*." *Chiarella*, 445 U.S. at 234-235 (emphasis added). They stand equally in derogation of this Court's past explanation that "'[m]anipulation' is 'virtually a term of art when used in connection with securities markets'" that refers narrowly to "practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Industries* v. *Green*, 430 U.S. at 476 (quoting *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 (1976)). Most important of all, they make criminals out of persons whose behavior is neither reprehensible nor the subject of any statutory or regulatory "fair warning of the boundaries of criminal conduct." *Crandon*, 494 U.S. at 158. Results like these are the consequence of a doctrinaire belief that securities

prices *must* be set exclusively by "the ebb and flow of the market * * * responding to natural forces" (whatever that means), App., *infra*, 48a, and not by the varied interests of investors who are willing to put their own money at risk in arm's-length transactions in order to serve non-economic goals. But criminal convictions must be based on violations of the laws enacted by Congress, not perceived violations of the "laws" of economics.[14]

Even from an economist's perspective, there is no reason to expand the category of prohibited securities "manipulation" to include actual trades made with the intent to affect prices, and much danger of deterring or penalizing innocent or socially desirable acts by doing so. See Fischel & Ross, *supra*, 105 HARV. L. REV. at 507 ("Fictitious trades should be analyzed as a species of fraud. Actual trades should not be prohibited as manipulative regardless of the intent of the trader"). Indeed, activities such as petitioner's—which, if they had had any effect at all, would have moved prices *closer* to what petitioner perceived as their correct level—are socially *beneficial*. See *id.* at 508 ("[T]rading with the purpose of producing a

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[14] As Professor Thel explains:

> The SEC has occasionally [argued] that investors should be able to count on prices' reflecting normal supply and demand, or at least on prices' not reflecting supply and demand that is created solely for the purpose of influencing prices. But the SEC cannot explain why investors' reliance is binding on traders. * * * In any case, even if investors do believe that they participate in a model market, that would only show that investors are mistaken, not that anomalous traders have misled (or deceived) them. *Both at common law and under section 10(b) the misinformed can prove fraud only by showing that the deceiver has done something wrong. Aside from the relatively few traders who affirmatively misrepresent themselves, traders who trade for non-investment reasons or who affect prices by the way that they trade are not using a deceptive device or contrivance, unless they either are trying to mislead other investors or are trading in violation of some independent rule against their trading.*

1988 COLUM. BUS. L. REV. at 428 (emphasis added).

price change is not necessarily harmful. * * * [When] trading moves prices in the correct direction * * * the resulting price change should not be labeled 'artificial' "); see also *id.* at 524. Even if one disregards or discounts the fact that petitioner would have done a public *service* if he had succeeded in countering COMB's "levitation," and deems his alleged intent "bad" for some reason, there is still, as Fischel and Ross demonstrate, no reason to condemn it. See *id.* at 509-510.[15]

There is, at the same time, much reason *not* to construe the securities laws to prohibit genuine trades (as opposed to phony ones) solely because of the intent of the trader. For one thing, there is much danger of misclassifying many legitimate trades as illegitimate if the dividing line is "intent" alone. "[T]here is no objectively harmful act or bad outcome. Only the trades are observable, and they are indistinguishable from all other trades. * * * [T]he objective conduct deemed to indicate manipulation is at least as consistent, if not more consistent, with normal market activity." 105 HARV. L. REV. at 519. In addition, such an amorphous rule against

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[15] As those writers observe, it does not advance the analysis to label the investor's trading as "fraud":

> Consider the example of a trader who trades with "bad" intent—he attempts to affect the price with no belief that the price would otherwise move in this direction. Would such a trader be deemed to have engaged in fraud? It could be argued that the trader has engaged in fraud by acting (that is, trading) for the purpose of misleading market participants about the true value of the security. But there is a critical difference between the typical fraud and the trading in this example. The typical fraud involves a bad act (a false statement) as well as an intent to defraud. * * * *
>
> Thus, the trader in the above example presents a very different case from the one engaging in fictitious trades or making false statements, *because the former has not engaged in any conduct that can be objectively determined to be socially undesirable.* The only act is trading, trading that cannot be distinguished from other trading using objective measures.

105 HARV. L. REV. at 511 (footnote omitted; emphasis added).

bad intent would deter beneficial activities. *Id.* at 522-523.

The time for this Court to review the issue is now. Never since the Great Depression has so much attention focused on Wall Street trading. See *Mulheren*, 938 F.2d at 365 (discussing the "wide prosecutorial net * * * cast upon Wall Street"). For the most part, the guilty have been punished and the innocent have, as in Mulheren's case, been vindicated in the courts. But the recent prosecutions, particularly *Mulheren*, have also taught lessons that the Second Circuit failed to heed here. It has become clear that "the observable characteristics of trades cannot distinguish trades made with bad intent from trades made with good intent"; it has similarly become clear that there is an extremely serious question under existing law "whether actual trades should be prohibited as manipulative." Fischel & Ross, *supra*, 105 HARV. L. REV. at 533 (discussing and endorsing implications of the analysis in *Mulheren*). Yet the Second Circuit in this case failed to vindicate a man who committed no crime, and it pronounced a rule that plainly *does* allow criminal convictions to stand based on nothing more than an actual trade with an intent to affect prices. Because that rule is wrong as a matter of precedent, wrong as a matter of policy, far-reaching in its implications, and unjust in its particular application here, this Court should grant review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JANUARY 1992

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Nos. 25 to 30, Dockets 89-1591, 89-1592, 89-1600 to 89-1602 and 89-1614

UNITED STATES OF AMERICA, APPELLEE

v.

JAMES SUTTON REGAN, JACK Z. RABINOWITZ, STEVEN BARRY SMOTRICH, CHARLES M. ZARZECKI, PAUL A. BERKMAN, and BRUCE LEE NEWBERG, DEFENDANTS-APPELLANTS

Argued Jan. 24, 1991

Decided June 28, 1991

Before VAN GRAAFEILAND, MINER, and MAHONEY, Circuit Judges.

VAN GRAAFEILAND, Circuit Judge:

James S. Regan, Jack Z. Rabinowitz, Steven B. Smotrich, Charles M. Zarzecki, Paul A. Berkman, and Bruce L. Newberg appeal from judgments of the United States District Court for the Southern District of New York (Carter, J.) convicting them of

tax fraud, securities fraud, mail and wire fraud, false partnership records and reports, conspiracy to commit all of the foregoing, and RICO. All of the appellants, save Newberg, were associated with Princeton Newport Partners, L.P. (PN), a limited partnership investment firm with offices in New Jersey and California. Appellant Regan was a managing partner and the firm's resident "tax authority".[1] For convenience of discussion, we have divided the charges against appellants into two general groupings, one dealing with alleged tax fraud and the other dealing with alleged securities fraud.

THE TAX FRAUDS

A stockbroker who sells stock that he does not own must either buy or borrow it from someone else in order to make delivery on the settlement date. Because the two methods of procurement have different legal consequences, including the resultant tax treatment, it is important to know what method the broker used.

In 1978, Congress created a means for making this determination at least in part by enacting section 1058 of the Code, 26 U.S.C. § 1058. *See* S.Rep. No. 762, 95th Cong., 2d Sess. 7, *reprinted in* 1978 U.S. Code Cong. & Admin.News 1286, 1292-93. Section 1058 provides in substance that no gain or loss shall be recognized if the procurement transaction is made pursuant to an agreement that (1) provides for the return of securities identical to those transferred; (2)

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[1] For a more complete factual background, see Judge Carter's opinions reported at 699 F.Supp. 36, 706 F.Supp. 1102, 713 F.Supp. 629, and 726 F.Supp. 447, and this court's prior opinion reported at 858 F.2d 115.

requires that payment be made to the transferor in amounts equal to the interest, dividends, and other distributions paid on the transferred securities; (3) does not reduce the transferor's risk of loss or opportunity for gain on the transferred securities; and (4) meets such other requirements as may be prescribed by Treasury regulations.

In 1983, the Secretary of the Treasury proposed regulation 1.1058-1, which, although never promulgated, shed light upon the meaning of section 1058. Subdivision (e) of the proposed regulation provides in substance that, if a transfer of securities is intended to comply with section 1058 but fails to do so because the transfer agreement does not satisfy the above-described requirements of that section, gain or loss will be recognized on the transfer in accordance with 26 U.S.C. § 1001.

From time to time in the period between 1984 and 1987, PN owned substantial quantities of stock that had depreciated in value and whose sale would provide PN with opportunities to take tax losses. Regan testified that, prompted by correspondence from his accountants, a report of the Tax Section of the Association of the Bar of the City of New York, and his own study of section 1058 and proposed regulation 1.1058-1, he concluded that PN could take those losses by means of sales and repurchase arrangements with other brokerage or investment houses so long as the arrangements between PN and the other houses did not satisfy the requirements of section 1058. Regan felt that this very lack of compliance would enable PN to take tax losses on the transactions. Based on this belief, PN entered into some fifty-nine transactions with other brokerage and investment houses, consisting of sales of stock by PN

to those houses and agreements to resell to PN at fixed prices at later dates.

Appellants, following Regan's lead, believed that these transactions did not satisfy section 1058 requirements in that their terms were not reduced to writing, did not provide for termination upon short notice, and did not contain legally enforceable rights of repurchase. Moreover, the brokerage houses to whom the stock was sold had complete control of the stock in their possession while PN had none, thus depriving PN of the opportunity to avoid loss or capitalize on gain during that period. Also, the agreed-upon repurchase price might vary substantially from the then-existing market price.

The district court described this as a "sophistical" treatment of section 1058, 726 F.Supp. at 451, and rejected it out of hand. Stating that he didn't think he had "to give a contention that was contrary to what [he] regard[ed] as being the law" (Tr. at 4046), he held that appellants' contention concerning section 1058 had no substance and the section had "no applicability to defendants' case," 726 F.Supp. at 451. This was prejudicial error. The issue in the case was not whether appellants' construction of section 1058 was correct or even objectively reasonable but whether it was made in good faith. *Cheek v. United States*, —— U.S. ——, 111 S.Ct. 604, 611, 112 L.Ed.2d 617 (1991); *United States v. Murdock*, 290 U.S. 389, 395-98, 54 S.Ct. 223, 225-26, 78 L.Ed. 381 (1933); *United States v. Pabisz*, 936 F.2d 80, 83 (2d Cir.1991); *see also United States v. Aitken*, 755 F.2d 188, 189-93 (1st Cir.1985).

Although appellants were not charged with violating section 1058, that section became pivotal in the

case because appellants believed that it authorized them to do just what they did, *i.e.*, take tax losses. If this belief was held in good faith, they could not be held criminally liable for proceeding on that basis. Appellants offered substantial evidence of their good faith reliance on their interpretation of section 1058, some of which the court received and some of which it rejected. For example, the Tax Section of the Association of the Bar of the City of New York appears to have interpreted section 1058 in somewhat the same manner as did Regan. The report of the Committee upon which Regan relied stated in substance that the distinguishing feature between a loan and a sale of securities was whether the risk of loss or opportunity for gain was retained by the person making the transfer. This, of course, was in accord with the generally accepted rule that "for Federal income tax purposes, the owner of property must possess meaningful burdens and benefits of ownership." *See* H.R. Rep. No. 432, 98th Cong., 2d Sess., pt. 2, at 1132, *reprinted in* 1984 U.S.Code Cong. & Admin.News 697, 806. Appellants also offered the testimony of two acknowledged tax experts to the effect that Regan's interpretation of section 1058 was not unreasonable, but the district court refused to permit these experts to testify.

Whether, as appellants contend, the district court erred in its evidentiary rulings concerning this evidence is a matter we need not decide. The issue of appellants' good faith reliance on section 1058 as appellants interpreted it was squarely raised and argued. The district court should have instructed the jury that, if it found the reliance was held in good faith, the defendants could not be held criminally liable for proceeding in accordance with that reliance.

See United States v. Durham, 825 F.2d 716, 719 (2d Cir.1987); *United States v. Pedroza*, 750 F.2d 187, 204-05 (2d Cir.1984), *cert. denied*, 479 U.S. 842, 107 S.Ct. 151, 93 L.Ed.2d 92 (1986); *United States v. Alfonso-Perez*, 535 F.2d 1362, 1365 (2d Cir.1976).

The record is clear that appellants requested a charge specifically directed to their claim of good faith reliance on section 1058. Indeed, they even cited *Durham, supra,* to the district court as authority for their entitlement to such a charge. Quoting *Pedroza, supra,* we said in *Durham* that "the court's general instructions on specific intent were not 'adequate to inform the jury that if it believed the defendants' theory it was entitled to conclude that they did not have the requisite intent to be convicted of the offenses charged.'" 825 F.2d at 719. In the instant case, where appellants were charged with sixty-four counts covering the waterfront of tax fraud, securities fraud, mail and wire fraud, conspiracy, and RICO, a generalized charge on good faith was insufficient to instruct the jury concerning appellants' specific good faith defense based on section 1058. Appellants were entitled to have the trial court clearly instruct the jury, relative to appellants' theory of defense to the tax charges, that the theory if believed justified acquittal on those charges. *Alfonso-Perez, supra,* 535 F.2d at 1365.

One of the most esoteric areas of the law is that of federal taxation. It is replete with "full-grown intricacies", and it is rare that a "simple, direct statement of the law can be made without caveat." 1 *Mertens Law of Federal Income Tax* § 1.01. Justice White, writing for the Court majority in *Cheek, supra,* stated that, because of the proliferation of tax statutes and regulations, the common-law presumption that every person knows the law does not apply where violations

of federal criminal tax laws are alleged. Instead, proof of guilt in such cases must be predicated upon a " 'voluntary, intentional violation of a known legal duty.' " 111 S.Ct. at 610 (quoting *United States v. Bishop*, 412 U.S. 346, 360, 93 S.Ct. 2008, 2017, 36 L.Ed.2d 941 (1973)).

This rule applies to alleged violations of the "hierarchy of tax offenses set forth in §§ 7201-7207, inclusive." *United States v. Bishop*, 412 U.S. 346, 359, 93 S.Ct. 2008, 2016, 36 L.Ed.2d 941 (1973). It also applies to 18 U.S.C. § 371 conspiracies to violate one or more of the hierarchy of tax offenses. *Ingram v. United States*, 360 U.S. 672, 677-78, 79 S.Ct. 1314, 1318-19, 3 L.Ed.2d 1503 (1959); *United States v. Gurary*, 860 F.2d 521, 525 (2d Cir.1988), *cert. denied*, 490 U.S. 1035, 109 S.Ct. 1931, 104 L.Ed.2d 403 (1989).

The Government's burden in proving a mail or wire fraud offense, 18 U.S.C. §§ 1341 and 1343, is even more onerous. These are specific intent crimes. *United States v. Gelb*, 700 F.2d 875, 879 (2d Cir.), *cert. denied*, 464 U.S. 853, 104 S.Ct. 167, 78 L.Ed.2d 152 (1983); *United States v. Martin-Trigona*, 684 F.2d 485, 492 (7th Cir.1982). The Government is required to prove beyond a reasonable doubt that the defendant was guilty of a "conscious knowing intent to defraud." *United States v. Kyle*, 257 F.2d 559, 564 (2d Cir.1958), *cert. denied*, 358 U.S. 937, 79 S.Ct. 327, 3 L.Ed.2d 308 (1959). Such wrongful intent is the "essence of the crime." *Pelz v. United States*, 54 F.2d 1001, 1005 (2d Cir.1932). Where, as here, there is little dispute concerning the making and filing of the allegedly fraudulent returns, the existence vel non of culpable intent or lack of good faith is a crucially important issue in the case. *See United States v. Ballard*, 322 U.S. 78, 82, 64 S.Ct. 882, 884, 88 L.Ed.

1148 (1944); *United States v. Brandt*, 196 F.2d 653, 657 (2d Cir.1952); *United States v. Foshee*, 578 F.2d 629, 634 (5th Cir.1978).

Despite numerous requests by appellants to charge otherwise, the district court persisted in viewing section 1058 objectively, insisting that the court was the sole judge of the law. That, of course, was true. However, the issue for the jury was not how the district court interpreted section 1058; it was how the defendants in good faith interpreted it. "A jury is the ultimate discipline to a silly argument." *United States v. Burton*, 737 F.2d 439, 443 (5th Cir.1984). The district court's failure to squarely present this issue to the jury was a prejudicial error that tainted all of the tax hierarchy charges.

Because we are reversing and remanding the predicate tax offenses upon which the bulk of the RICO charge was based, and perforce the RICO charge itself, we need not become involved in the disputed issue whether federal tax violations can give rise to a RICO cause of action. *See United States v. Henderson*, 386 F. Supp. 1048, 1052-54 (S.D.N.Y. 1974). *But see United States v. Computer Sciences Corp.*, 689 F.2d 1181, 1187-88 n. 13 (4th Cir.1982), *cert. denied*, 459 U.S. 1105, 103 S.Ct. 729, 74 L.Ed.2d 953 (1983). Before this lengthy case is retried, the Government may decide to withdraw the RICO count in view of the Department of Justice's July 1989 guidelines, which substantially curtail the use of tax frauds as direct or indirect predicate RICO offenses, and the district court's judicious decision to eliminate the forfeiture of assets by the defendants Regan, Rabinowitz, Berkman, and Smotrich. *See* 726 F.Supp. at 459.

Appellants contend further that the district court's charge concerning "economic substance", a necessary

element of a tax deductible loss, also was prejudicially erroneous. The court charged the jury that a transaction is without economic substance if (1) the transaction had no business purpose apart from the creation of tax deductions and (2) the transaction was subject to no market risk. The court stated that transactions have no business purpose apart from the creation of tax deductions if they are not intended either to make or preserve any profit or to limit a loss in any way except for the tax benefits and that transactions are subject to no market risk "if changes in market price cannct have any effect on the transaction."

When appellants objected to this charge, the district court stated that it was substantially the same charge that we approved in *United States v. Atkins*, 869 F.2d 135, 140 (2d Cir.), *cert. denied*, —— U.S. ——, 110 S.Ct. 72, 107 L.Ed.2d 39 (1989), and *United States v. Ingredient Technology Corp.*, 698 F.2d 88, 97 n. 9 (2d Cir.), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983), and the district court saw no reason to change it. However, a charge that is adequate and proper in one case may not play the same role in another case involving a different set of facts. The district court must tailor its instructions to the facts of the case before it. 2 C. Wright, *Federal Practice and Procedure* § 485, at 710-13. "Each case has its own peculiar facts and formalized instructions must be tailored to the facts and issues." Devitt, *Ten Practical Suggestions About Federal Jury Instructions*, 38 F.R.D. 75, 77 (1965).

Appellants contend that, while the use of the phrase "creation of tax deductions" was proper in *Atkins* and *Ingredient Technology* where it referred to the artificial creation of losses upon which claims for tax

deductions could be made, it was not proper where, as here, it referred to the creation of tax deductions based upon legitimate book losses that already existed. To be allowable as an income tax deduction, a business loss must be evidenced by a closed and completed transaction, *i.e.*, "some identifiable event ending the interest of the taxpayer in the property." *Williams v. Commissioner*, 584 F.2d 90, 94 (5th Cir. 1978) (per curiam); *see* 26 C.F.R. § 1.165-1(b). In this respect, every taxpayer who claims a deduction based on the sale of an asset that has depreciated in value may be said to have "created a tax deduction." Appellants point out that the sales at issue herein were made at or near the market price of the stock that was sold. They assert correctly that, as a basic proposition, a bona fide sale that has no sham implications may receive favorable tax treatment even though it is made for the express purpose of realizing an existing book loss. *See* 7 *Mertens Law of Federal Income Taxation* § 28.08, at 47.

A similar problem exists with respect to the district court's definition of "no market risk", *i.e.*, that there is no market risk "if changes in market price cannot have any effect on the transaction." We assume that what the district court meant by this phrase is that there would be no market risk if the transaction would be carried through to completion as planned regardless of any movement in the market. This is not the same as saying that there would be no market risk if market movements had no "effect" on the transaction. In the instant case, movements in the market would have an effect on the transaction. As already pointed out, the brokerage houses to whom PN sold its stock had control of the stock in their possession. They could sell and re-

purchase in response to movements in the market, but PN could not. At the time the stock was returned, its actual market value might be substantially below the previously agreed upon price. It cannot be gainsaid that the transactions at issue brought about changes in the economic interests of the parties. *See Rosenfeld v. Commissioner*, 706 F.2d 1277, 1282-83 (2d Cir.1983).

Without deciding whether, standing alone, the above-discussed problems associated with the district court's charge are of sufficient importance to require that the matter be submitted to another jury, we conclude that they provide added support for that disposition.

THE SECURITIES FRAUD

In March 1985, the firm of Drexel Burnham Lambert, Inc. was retained to underwrite a $25 million convertible bond offering for C.O.M.B. Co., a Minneapolis concern. Such bonds pay a fixed rate of interest and are convertible into common stock at a predetermined price. Accordingly, the higher the market value of the stock when the convertible bonds are offered for sale the more advantageous from the convertible standpoint the purchase of the bonds will appear to be. Because of this, the bonds can be sold at a lesser interest rate. Accordingly, corporations contemplating convertible bond offerings usually hope for a high market price for their stock and, in some cases, attempt to "levitate" the price into a higher range. This, of course, could adversely affect sales to those purchasers who are interested primarily in interest income. It also could adversely affect sales to prudent investors who are concerned about stock manipulation.

The Government's contention in substance is that, in the period just prior to the finalization of the underwriting agreement, Drexel, believing that C.O.M.B. was "levitating" the price of its stock, undertook by devious means to depress the price. Appellant Newberg, a bond trader for Drexel, sought to accomplish this by arranging with appellant Zarzecki, a trader for PN, for PN to sell 40,000 shares of C.O.M.B. short to a broker-dealer without disclosing to the dealer that PN was the seller or that Drexel was the moving party behind the entire deal. The Government contends that this was a violation of section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, which bar the use of any device, scheme, or artifice to defraud, or any manipulative or deceptive device or contrivance in contravention of pertinent SEC rules and regulations. The jury, under proper charge, so found.

In enacting section 10(b), "Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices." *Santa Fe Indus. v. Green*, 430 U.S. 462, 477, 97 S.Ct. 1292, 1303, 51 L.Ed.2d 480 (1977). For an informative discussion of the diverse devices that ingenious minds have conceived, see 3 Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud* § 7.3(220)-(227). The plan conceived by Newberg and Zarzecki fits comfortably wihtin this "full range" of wrongful acts. *See, e.g., Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 792-93 (2d Cir.1969), *cert. denied*, 400 U.S. 822, 91 S.Ct. 41, 27 L.Ed.2d 50 (1970). "Failure to disclose that market prices are being artificially depressed operates as a deceit on the market place and is an omission of a material fact."

United States v. Charnay, 537 F.2d 341, 351 (9th Cir.), *cert. denied*, 429 U.S. 1000, 97 S.Ct. 527, 50 L.Ed.2d 610 (1976). Appellants' argument that a fiduciary relationship must exist before liability can be found is without merit. The case of *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980), upon which appellants rely involved trading on the basis of nonpublic information; here, appellants are charged with market manipulation. In sum, Newberg's and Zarzecki's convictions on the counts charging market manipulation in connection with the C.O.M.B. offering must be affirmed. Because all of the appellants were convicted on the conspiracy count which incorporates the charges of manipulating C.O.M.B.'s stock, their convictions on the conspiracy count also must be affirmed *See United States v. Dixon*, 536 F.2d 1388, 1401-02 (2d Cir. 1976).

The Government has not requested that we salvage the RICO count by using only the C.O.M.B. securities fraud as the predicate act. Because we are remanding for a new trial on nine of the ten racketeering acts alleged in the RICO count and it is not clear that the jury would have found a RICO violation based on the 10 percent of the acts that remain, we believe that it is best to remand the portion of the RICO count that is based on the securities fraud along with the portion that is based on the tax frauds. *See United States v. Ruggiero*, 726 F.2d 913, 922 (2d Cir.), *cert. denied*, 469 U.S. 831, 105 S.Ct. 118, 83 L.Ed.2d 60 (1984).

CONCLUSION

Conviction of all of the appellants on the conspiracy count, count no. 1, is affirmed. Conviction of appellant Newberg on the securities fraud counts, nos. 48 to 53, is affirmed. His conviction on all other counts save that of consipracy is vacated, and the issues on those counts are remanded to the district court for further proceedings. Conviction of Zarzecki on the securities fraud count, no. 53, is affirmed. His conviction on all other counts save that of conspiracy is vacated, and the issues on those counts are remanded to the district court for further proceedings. Conviction of appellants Regan, Rabinowitz, Berkman, and Smotrich on all counts save that of conspiracy are vacated, and the issues on those counts are remanded to the district court for further proceedings.

MAHONEY, Circuit Judge, concurring in part and dissenting in part:

I agree with my colleagues that the securities fraud and conspiracy counts should be affirmed. I do not agree, however, that reversal of the tax and related counts is warranted by the district court's refusal specifically to instruct the jury regarding the defendants' asserted reliance on 26 U.S.C. § 1058. Nor do I perceive any error in the court's charge concerning "economic substance." I therefore respectfully dissent from the majority's rulings regarding the instructions of the district court.

A. *The "Good Faith" Instructions.*

My colleagues conclude: "The district court should have instructed the jury that, if it found that the reliance [on section 1058 as appellants interpreted it] was held in good faith, the defendants could not be

held criminally liable for proceeding in accordance with that reliance." The district court in fact gave the following instructions with regard to good faith:

> If you find that the defendant acted in good faith in the honest belief that the representations he made were true, that he did not intend to defraud anyone, this constitutes a complete defense to the crime of mail or wire fraud.
>
> . . . .
>
> The defendants contend the government has failed to prove that they did not act in good faith.
>
> Mr. Regan submits that it was his belief, based on his general knowledge of the tax laws and buttressed by the willingness of Akroyd and Merrill Lynch to engage in these trades, that both the day trades done in 1984 and the 31 day trades done in 1985 were entirely proper for tax purposes.
>
> The other Princeton/Newport defendants contend that they relied on Mr. Regan's opinion as to the propriety of the trades. . . .

In connection with the false return counts, the court additionally instructed as follows:

> If the defendant signed the tax return in good faith and believed it to be true in all material matters, he has not committed a crime and must be acquitted on these counts, even if the return was incorrect.
>
> If you find that the tax return was not true as to a material matter, the central question is whether or not the defendant honestly believed that the return was true. The government has

> the burden of proving that the defendant did not have an honest belief in the truthfulness of the return.

Characterizing these rather extensive instructions as a "generalized charge on good faith," my colleagues find them "insufficient to instruct the jury concerning the appellants' specific good faith defense based on section 1058." In other words, the defendants were prejudiced by an instruction that their good faith defense was premised on Regan's "general knowledge of the tax laws," because defendants more specifically contended that Regan relied on section 1058. I am unpersuaded that a district court is required to present a defendant's contentions with this level of particularity. The fact is that the theory of defense —to wit, bona fide reliance on the tax code—was squarely presented to the jury. It is unlikely that the jurors were misled because the district court failed to remind them of Regan's contention that section 1058 was at the center of his tax analysis.

Even assuming, however, that the district court arguably should have given an instruction more closely patterned after the defendants' section 1058 contention, the record does not disclose the specific objection to the court's instruction on the intent issue required by Fed.R.Crim.P. 30 to preserve a claim of instructional error. Defendants' proposed jury instructions included a paragraph that essentially summarized Regan's trial testimony regarding reliance on section 1058. When Judge Carter indicated at the charging conference that his instructions would not refer to section 1058, however, counsel did not contest the ruling, let alone argue that the defense theory would be gutted. After delivery of the charge, the only objections relating to defense contentions were

that the court (1) failed to instruct that defendant Zarzecki contended that he never participated in any illegal activity, and (2) failed to instruct the jury on all the defense contentions concerning the manipulation of C.O.M.B. Co. securities. In response, the district court gave a supplemental instruction that both the government and the defendants had set forth more contentions than those presented in the jury charge.

In these circumstances, reversal may be premised only upon "plain error" in the jury instruction, *see* Fed.R.Crim.P. 52(b); *i.e.*, where "failure to reverse would result in 'a miscarriage of justice which denied the defendant a fair trial.'" *United States v. Scarpa*, 913 F.2d 993, 1021 (2d Cir.1990) (quoting *United States v. Civelli*, 883 F.2d 191, 194 (2d Cir.), *cert. denied*, —— U.S. ——, 110 S.Ct. 409, 107 L.Ed.2d 374 (1989)). This doctrine is to be invoked sparingly, *see Scarpa*, 913 F.2d at 1021 (collecting cases), and I see no occasion for its application here.

B. *The "Economic Substance" Instruction.*

My colleagues find "added support" for their reversal of the tax related convictions from two criticisms of the district court's instructional definition of economic substance. Briefly, the government's theory of the case was as follows. PN invested in the so-called "convertible hedge," establishing a long position in convertible bonds while selling short the underlying stocks. With this hedged position, price fluctuations on the "long" side would more or less exactly be compensated by fluctuations on the "short" side. At the relevant times, short term capital losses were accorded beneficial treatment under the Internal Revenue Code.

In order to reap this tax benefit without disturbing the balance of their hedged position, the defendants

concocted false sales of their losing securities. Specifically, PN would "sell" the securities to a brokerage house just before the end of the maximum short term holding period, with the understanding that PN would repurchase the securities at approximately the same price shortly thereafter. The government charged that the purported sales (whereby PN incurred and reported the short term losses) lacked economic substance, and that the losses were therefore unlawfully reported on PN's partnership returns.

The district court charged the jury that a transaction lacked economic substance if it (1) "had no business purpose apart from the creation of tax deductions" and (2) "was subject to no market risk." My colleagues criticize the first branch of this definition on the ground that the language "creation of tax deductions" might unfairly encompass a bona fide sale that is intended to realize an existing loss. This criticism was not presented to the district court either at the charging conference or in defendants' numerous objections following the charge. Indeed, the following similar language was contained in defendants' proposed jury instructions: "A sale has economic substance if it *could possibly* have an economic effect *other than the creation of a tax deduction* and the payment of the sales price and costs incident to the sale. . . ." (latter emphasis added).

Further, in *United States v. Atkins*, 869 F.2d 135 (2d Cir.1989), we approved the use of the same charge in a strikingly similar context. The defendants attempt to distinguish *Atkins* on the theory that its definition of economic substance applies only to cases in which phony losses are created, not cases where actual losses are *recognized* through the use of sham transactions. This will not do. *Atkins* involved

a scheme falsely to *recognize* actual losses in value on the short legs of straddles via artificial sales and repurchases. Like this case, *Atkins* involved not false losses but false sales.

Finally, my colleagues are dissatisfied with the court's instruction "that transactions are subject to no market risk if changes in market prices cannot have any effect on the transaction." They essentially contend that PN took the risk that the parking transaction—the prearranged sales and repurchases at nearly identical prices—would not, as the majority puts it, be "carried through to completion as planned regardless of any movement in the market." In other words, after a brokerage house took possession of the parked securities, it might refuse to honor the prearranged transfer of the securities back to PN.

The risk that the brokerage house might sell the parked securities to a third party or otherwise decline to return them, despite the agreement to the contrary, seems indistinguishable from the risk in *United States v. Ingredient Technology Corp.*, 698 F.2d 88 (2d Cir.), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983), that the seller of inventory to the taxpayer would refuse to repurchase that inventory as agreed. We nonetheless there held that the lack of an enforceable agreement did not result in risk that imparted such economic substance to the transaction as to preclude tax fraud. *Id.* at 94-95.

Moreover, the jury was entitled to consider the whole of the parking scheme to be the transaction that lacked economic substance. For example, in *United States v. Glass*, 87 T.C. 1087 (1986), the taxpayers had invested, through straddles, in options for

future delivery of a specified metal in a manner that would produce an ordinary loss in the initial tax year, and a capital gain in the next. *See id.* at 1095. The Tax Court concluded that the transaction that created the loss for the first year—the closing of the loss leg of the straddle—lacked economic substance. In disallowing the deductions, the court looked to the entirety of the tax avoidance scheme:

> In determining deductibility, we believe that substance-over-form precludes us from focusing solely upon the losses incurred by the closing of the sold options in year one of the London options strategy, to the exclusion of all that followed. For this reason we hold, as we have done before, that the relevant transaction was petitioners' entire commodity tax straddle scheme. . . . What petitioners invested in here with the respective broker/dealers was a prearranged sequence of trading calculated to achieve a tax-avoidance objective—not investments held for non-tax profit objective.

87 T.C. at 1163.

I note that because of the plethora of taxpayers involved in the case, the *Glass* decision has been affirmed on appeal by at least eight circuits. *See Lee v. Commissioner*, 897 F.2d 915 (8th Cir. 1989); *Dewees v. Commissioner*, 870 F.2d 21 (1st Cir.1989); *Friedman v. Commissioner*, 869 F.2d 785 (4th Cir. 1989); *Keane v. Commissioner*, 865 F.2d 1088 (9th Cir.1989); *Ratliff v. Commissioner*, 865 F.2d 97 (6th Cir.1989); *Killingsworth v. Commissioner*, 864 F.2d 1214 (5th Cir.1989); *Kirchman v. Commissioner*, 862 F.2d 1486 (11th Cir.1989); *Yosha v. Commissioner*, 861 F.2d 494 (7th Cir.1988).

Further, I note that Judges Breyer and Posner observed that while the straddle trading *in theory* might involve economic substance, the Tax Court did not err in concluding that the particular trades at issue were executed in a manner that lacked economic substance. *See Dewees*, 870 F.2d at 32; *Yosha*, 861 F.2d at 499.

In sum, I do not concur in the majority's rulings regarding instructional error by the district court, and therefore respectfully dissent from those rulings. I do not reach the complex of issues concerning the tax and related counts that would be presented if the majority shared my views concerning the jury charge.

APPENDIX B

UNITED STATES DISTRICT COURT
S.D. NEW YORK

No. S 88 Cr. 517 (RLC)

UNITED STATES OF AMERICA

v.

JAMES SUTTON REGAN, CHARLES M. ZARZECKI, JACK Z. RABINOWITZ, PAUL BERKMAN, STEVEN BARRY SMOTRICH, BRUCE LEE NEWBERG, DEFENDANTS

Nov. 27, 1989

ROBERT L. CARTER, District Judge.

Defendants James Sutton Regan, Jack Z. Rabinowitz, Charles M. Zarzecki, Paul A. Berkman, Steven B. Smotrich and Bruce Lee Newberg were brought to trial on June 19, 1989, on a superseding indictment charging conspiracy to commit securities, mail and wire fraud, to maintain false books and records, and to file fraudulent tax returns; substantive securities, mail and wire fraud, and tax violations; a RICO conspiracy; and substantive RICO violations. Defendants, except for Bruce Lee Newberg, are general partners or executives in Princeton/Newport Partners,

L.P. ("PNP"). Newberg was a trader in the High Yield and Convertible Bond Department of Drexel Burnham Lambert, Inc. ("Drexel") in Beverly Hills, California. Prior to trial the court dismissed counts 49, 50 and 51, and predicate act 9 of the RICO counts. *United States v. Regan*, 713 F.Supp. 629 (S.D.N.Y. 1989) (Carter, J.).[1] The indictment was then redacted and the remaining counts renumbered. The trial was bifurcated, with the jury being required to determine first defendants' guilt or innocence. When and if the jury returned verdicts of guilty on the RICO counts, proof and argument relevant to RICO forfeiture were then to be presented for the jury's determination.

Following the completion of the evidentiary phase of the trial but before submission to the jury, newly numbered counts 52, 53, 54 and 55 of the superseding indictment were dismissed. The remaining 64 counts were renumbered in a second redaction of the superseding indictment and presented to the jury on July 27, 1989. On July 31, 1989, the jury returned verdicts of guilty on all counts except count 54, which charged defendants Zarzecki and Newberg with securities fraud in connection with an April 15, 1985 transaction involving C.O.M.B. ("COMB") securities.

On August 1, 1989, proceedings to determine the RICO forfeitures commenced. The government submitted a stipulation listing the defendants' partnership shares, salaries and Newberg's W-2 forms for 1984-1986, and a redacted copy of Drexel's plea agree-

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[1] The above cited opinion, 706 F.Supp. 1102 (1989) and 699 F.2d 36 (1988) are the court's pretrial opinions in this case and provide more extensive background facts than are to be found in the current opinion.

ment.[2] Smotrich presented an affidavit attesting to the comparability of his salary to those of other officials in the industry performing his functions, and Newberg offered copies of his 1984-1985 tax returns. Defendants and the government then presented arguments to the jury on the forfeiture question. After deliberations, the jury found the government had sustained its burden of proof beyond a reasonable doubt that Regan, Rabinowitz, Zarzecki and Berkman had partnership interests in the enterprise, and that these defendants and Smotrich and Newberg had salaries and management fees. It determined the amount to be forfeited as follows: Regan $3 million, Rabinowitz, Berkman and Newberg $200,000 each, and Smotrich $1,245.85.

Defendants, as a group, now move for judgments of acquittal or a new trial. In addition, separate motions to this effect have been filed by Smotrich, Newberg and Zarzecki. A supplemental letter motion seeking dismissal of the RICO counts has been filed on behalf of all defendants. The government contends that the jury was required to order forfeiture of all defendants' interests in PNP and all fees (management and salary) received therefrom by any defendant, and moves to enforce mandatory forfeiture of all defendants' interests in the enterprise and all of their salaries and/or management fees received therefrom.

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[2] In a proceeding, somewhat peripheral to this one, various charges were brought against Drexel, including some similar to those brought against these defendants, particularly the charge of securities fraud in connection with COMB securities. Drexel entered into a plea agreement with the government pursuant to which Drexel pleaded guilty and paid a fine of $650 million.

I.

A.

Defendants spend considerable effort arguing that the tax parks were valid transactions, even on the assumption "that sales and purchases were prearranged, not subect to market risk and solely tax motivated." [3] Defendants' Memorandum in Support of Motion for Judgments of Acquittal or for a New Trial ("Def. Mem. for Acquittal") at 2. Viewing the evidence in the light most favorable to the government, as the court must, *United States v. Martino*, 759 F.2d 998, 1002 (2d Cir.1985), the jury had sufficient evidence to conclude that the tax parks were not bona fide sales or transfers but sham transactions with no possible gains or losses to PNP except the minimum administrative fees charged by the accommodating brokerage firm for holding the securities and returning them back to PNP at the end of the agreed upon period. As I understand the controlling law of this circuit, since these tax parks were not subject to market or other economic risks and were bogus purchases and sales in which the purported seller retained its proprietary interest in the security which had been allegedly bought by the accommodat-

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[3] The term "tax park" refers to arrangements between PNP and cooperating brokerage houses whereby PNP would purport to "sell" various securities at their current market rate to a brokerage house pursuant to a prearranged agreement. Under such agreements, the securities would be held by the brokerage house for an agreed upon period then sold back to PNP at the same price at which it had originally "sold" the securities, plus a small fee to cover administrative costs. The purpose of the tax parks was to allow PNP to realize a loss on various securities for income tax purposes while in reality continuing to own the securities.

ing brokerage firm, the transactions were mere pretenses and a fraud on the government. *United States v. Atkins*, 869 F.2d 135, 146 (2d Cir.), *cert. denied*, —— U.S. ——, 110 S.Ct. 72, 107 L.Ed.2d 39 (1989); *United States v. Ingredient Technology Corp.*, 698 F.2d 88, 94-95 (2d Cir.), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983).

Defendants point out that what constitutes a "bona fide sale" is often a matter of debate and that a taxpayer is allowed to take a tax position, even if the taxpayer realizes that such position is unlikely to receive a favorable ruling, so long as a "reasonable basis" exists for such position. This is a correct statement of tax law, but misses the point. This is not a case about an honest effort to advance a tax argument unlikely to succeed. The jury found that defendants had fraudulent intent, and, therefore, the claim that there was a "reasonable basis" for defendants' tax position was rejected. Unless the jury's finding lacks substantial evidence to support it, *United States v. Wiley*, 846 F.2d 150, 153 (2d Cir.1988); *United States v. Buck*, 804 F.2d 239, 242 (2d Cir.1986), it remains undisturbed.

Defendants also make much of the fact that PNP was a profitable investment company which held securities that had declined in market value, and was not simply a tax-shelter factory. While this is true, it again misses the point. Defendants ignore the fact that the jury found them to have fraudulent intent in respect of the tax parks, and, therefore, statements about the bona fides of their business operations as a whole are irrelevant.

As they did at trial, defendants undertake a sophistical treatment of 26 U.S.C. § 1058 (1988) to support

their unsound position. Section 1058 and the regulations thereto [4] provide rules for the income tax treatment of securities lending transactions. If the provisions of § 1058 and the regulations are met, the lender does not recognize a gain or loss on the transfer of securities or the return of identical securities. In order to meet § 1058 requirements,[5] there must be an agreement which: (1) provides for the return of identical securities to the transferor; (2) requires that payments be made to the transferor in amounts equivalent to all interest and dividends paid on the lent securities; (3) does not reduce the risk of loss or opportunity for gain of the transferor of the securities, and, therefore, such agreement must provide that the lender may terminate the loan upon notice of not more than five business days.

Defendants argue that § 1058 draws a bright line between sales and loans of securities, and that under § 1058 the transactions in question should be treated as bona fide sales. Def. Mem. for Acquittal at 13. In particular, defendants argue that in the absence of a right to reacquire securities within five business days and a written loan agreement, a transaction in which securities change hands is a bona fide sale as a matter of law. *Id.* at 14-16.

Although no cases or rulings could be found which interpret § 1058, the relevant legislative history is contained in Senate Report No. 95-762 (April 25, 1978) (reprinted at 1978 U.S.Code Cong. & Admin. News 1286). According to the Senate Report, § 1058

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[4] Proposed Regulations § 1.1058, published in the Federal Register July 26, 1983.

[5] There are additional requirements for exempt organizations. *See* Proposed Regulations § 1.1058-1(b).

was enacted because of uncertainty regarding securities lending transactions. *Id.* at 1289. Apparently, the I.R.S. had declined to issue rulings as to whether securities lending transactions constituted a sale or exchange, and consequently there was some concern that transactions intended to be loans would be classified as sales. *Id.* at 1290. This concern discouraged the holders of securities from making such securities available for loans to brokers. *Id.* at 1289.

Because "[i]t is generally thought to be desirable to encourage organizations and individuals with securities holdings to make the securities available for such loans since the greater the volume of securities available for loan the less frequently will brokers fail to deliver a security to a purchaser within the time required by the relevant market rules," § 1058 was enacted to encourage the lending of securities to brokers to enable them to make timely deliveries of securities to purchasers. *Id.* at 1291. In sum, the legislative history shows § 1058 essentially to be a safe harbor for securities lending.

Despite the clear legislative history, defendants nevertheless argue that § 1058 is dispositive of their case. Basically, defendants' argument is that the realm of securities transactions is divided up into two categories: everything complying with § 1058 is a loan, and everything else is a sale. Since defendants' transactions clearly do not comply with the § 1058 requirements for loans, they argue that such transactions must, therefore, be sales.

The flaw in defendants' argument is that their vision is too limited. Contrary to defendants' assertions, § 1058 never defines a sale of securities and it does not follow that everything that is not a § 1058

loan is therefore a sale. Under defendants' logic, there could be no such thing as a sham sale because everything that is not a sale would have to be a loan. In sum, § 1058 has no applicability to defendants' case.

Defendants also argue that, under the relevant case law, their transactions were sales. Def. Mem. for Acquittal at 3-12, and Def. Reply Mem. for Acquittal at 2-6. Although defendants claim that the tax schemes in the cases upon which they rely "produced an economic result identical to that achieved by [PNP Arbitrage Partners]," Def. Mem. for Acquittal at 11, all of the cases relied upon involved situations where there was at least a minimum amount of market risk. In *Clark v. Commissioner*, 2 B.T.A. 555 (1925), *acq.*, IV-2 C.B. 2 [6], *Vauclain v. Commissioner*, 16 B.T.A. 1005 (1929), *acq.*, VIII-2 C.B. 54, and *Thiele v. Commissioner*, 32 B.T.A. 134 (1935), *acq.*, XIV-1 C.B. 20, the defendants bought and sold identical securities on the same day. Unlike these defendants, however, Clark, Vauclain and Thiele had to repurchase in the market and, therefore, their transactions were subject to market risk.

In *Doyle v. Commissioner*, 286 F.2d 654 (7th Cir. 1961), the taxpayer purchased and simultaneously sold short the same number of shares of stock that she already owned. This transaction also involved market risk because had the price of the stock dropped before delivery of the short sale, the taxpayer would have had to meet a margin call. It was, therefore, unlike defendants' sham activities.

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[6] This case also distinguished between an "accommodation sale" and a bona fide sale. *See* pp. 4-5.

In *Fisher v. Commissioner*, 30 B.T.A. 433 (1934), the taxpayer had an option to repurchase the stock sold. Although the taxpayer holding the option had no risk, the person against whom the option was held was at risk because he would stand to suffer a loss if the market went down. Accordingly, this was not a sham transaction.

In *Davey v. Commissioner*, 30 B.T.A. 837 (1934), the seller had a 90 day option to repurchase and the buyer had a 90 day option to require the seller to repurchase. The seller took a risk that the value of the securities would go down and the buyer would require him to repurchase, and the buyer took a risk that the value of the securities would go up and the seller would then repurchase them.

In short, all of the above cited cases are in contrast to the transactions in question here where neither side bore any risk whatsoever.

B.

Nor do I need linger on the claim that the RICO statute is unconstitutionally vague as the Court of Appeals has ruled to the contrary. *United States v. Scotto*, 641 F.2d 47, 52 (2d Cir.1980), *cert. denied*, 452 U.S. 961, 101 S.Ct. 3109, 69 L.Ed.2d 971 (1981). While a number of recent Supreme Court holdings indicate that *stare decisis* may not carry the force it once held, defendants must address their arguments to the Court of Appeals. I certainly have no authority to ignore its holdings.

C.

Defendants complain that there were two conspiracies instead of the single conspiracy found by the

jury. Whether the evidence establishes a single or several conspiracies is a question of fact for jury determination. *United States v. Friedman*, 854 F.2d 535, 562 (2d Cir.1988), *cert. denied*, —— U.S. ——, 109 S.Ct. 1637, 104 L.Ed.2d 153 (1989). The jury was charged as follows:

> The government contends that the indictment charges there was a single, all embracing conspiracy with several objectives. The defendants assert, without conceding that the government's proof establishes any conspiracy, that the evidence may permit an inference of more than the single conspiracy alleged in the indictment.
>
> The issue of whether there was one or more conspiracies is for you to decide. Proof of several separate conspiracies would not be proof of an overall conspiracy, unless one of the several conspiracies is the single conspiracy which the indictment covers.
>
> What you must do is determine whether the conspiracy charged in the indictment existed between two or more conspiracies. If you find no such conspiracy existed, then of course, you must acquit all the defendants of the conspiracy charge. However, if you are satisfied that such a conspiracy did exist, you must determine who were the members of that conspiracy as I told you before. In other words, to find a defendant guilty you must find he was a member of the conspiracy charged in this indictment and not a member of some other conspiracy, if you find there was any other.

Record at 4876.

Unless those instructions were in error, the only issue to be determined is whether, viewing the evidence in the light most favorable to the government, the evidence was sufficient to support the jury's finding of a single conspiracy.

The jury could readily conclude from the evidence that the defendants were engaged in tax parking to avoid being required to pay taxes which they ordinarily would have to pay, and that Zarzecki, on PNP's behalf in reciprocation, sought to assist Newberg and help Drexel in the COMB stock manipulation. The intimacy of the PNP headquarters where all the partner-defendants and Smotrich's offices were located, Hale's testimony and a Regan taped telephone conversation with Newberg constitute circumstantial evidence that Zarzecki's activities were done with the knowledge and approval of the other defendants. In any event, knowledge of the other defendants is immaterial. The law is so settled that all members need not be aware of all facts in a conspiracy or be involved in all facets of the conspiracy, *see, e.g., United States v. Nersesian*, 824 F.2d 1294, 1303 (2d Cir. 1987), that it is virtually sterile scholarship to cite authority in support of this proposition. Although it was reasonable for the jury to conclude that the partners and Smotrich were fully aware of what each of them were doing, even the lack of such overall knowledge by some of the defendants would not preclude the finding of a single overarching conspiracy in this case.

D.

In his individual motion, Zarzecki seeks acquittal on the mail and wire fraud counts, the tax fraud counts 60-64, and the RICO conspiracy counts. As indicated, the evidence showed that the PNP office

arrangement was an intimate one. Zarzecki was the head trader and his desk was a few feet from the desks of Hale and Berkman, PNP traders who arranged most of the tax parking transactions. Hale testified that Zarzecki complained to him about the commission PNP had to pay brokerage firms for allowing PNP to park its securities with them. Zarzecki also received month end pricing sheets generated on the computer with prices filled in by Berkman or Hale. To these sheets were stapled the list of parked securities and copies were distributed to all the PNP partners and to Smotrich. That evidence was sufficient for the jury to convict him on all the counts of which it found him guilty.

Newberg, a trader at Drexel, contends in his individual motion that he cannot be held for assisting in the preparation of false tax returns, for mail and wire fraud, RICO Acts 3, 4 and 8 of counts 2 and 3, Counts 26-45 and Counts 64-68. The evidence showed that on December 27, 1984, Berkman called Drexel to secure help in doing tax parks. Newberg was away and Berkman spoke to Cary Maultasch, Newberg's assistant, to whom he explained the purpose was to take a tax loss. Maultasch later advised Berkman that he had reached Newberg and obtained his approval, allowing Berkman to do the tax parks with Drexel.

Hale also testified concerning a meeting which took place in the PNP conference room just after year end 1984, when it was decided to park the securities with a prearranged agreement to buy them back after 31 days to avoid any impact the straddle rules might have. Regan said he would call Newberg to see if he could handle the tax parking for them. Record at 473. Later Regan announced in the trading room

that he talked to Newberg, and then PNP proceeded to park securities with Newberg. Record at 475. The jury could infer that Newberg knew that these tax parks were for illegal tax purposes and went along.

Individually, Smotrich argues that the taped conversations between Berkman and several officers of a brokerage house in Boston referred to at the trial as the Boston tapes, admitted for the limited purpose of providing the context in which Berkman's statements were made, Berkman's state of mind and to be used solely against him, were later illegally admitted against Smotrich when the court charged the jury that it could use the statements and acts of a proven member of the conspiracy made in furtherance of the conspiracy against any other member of the conspiracy. A similar complaint is made in regard to a conversation Zarzecki had with a relative of one of PNP's limited partners which also had been admitted solely as evidence of Zarzecki's state of mind. No objection was made by Smotrich or any other defendant at the time the allegedly offending charge was given lifting these limitations and allowing the tapes and conversation to be used against Smotrich as well. As the government points out, this was an oversight and had the matter been brought to the court's attention at the robing room conference after the charge had been given but before final submission of the case to the jury, an appropriate explanation could have been given to the jury to avoid any possible misunderstanding. Indeed, the record shows that the court, after conferring with counsel, returned to the courtroom and gave further clarifying instructions to the jury. By not making an objection at the time when the matter could have been clarified, defendant waived this objection and his claim of error now comes too

late. Rule 30, F.R.Cr.P.; *United States v. Friedman*, 854 F.2d 535, 555 (2d Cir.1988).

The remainder of Smotrich's claims is based on the premise that he should have been granted a separate trial. That issue was disposed of at the pretrial stage of these proceedings, *U.S. v. Regan*, *supra*, 713 F. Supp. at 641, and need not be revisited again here.

E.

In a separate letter motion dated October 16, 1989, the defendants bring to the court's attention internal memoranda distributed to prosecutorial personnel in the Department of Justice. The memorandum from Assistant Attorney General Edward S.G. Dennis, Jr. concerns the requirement for approval from the Department of Justice as a prerequisite to moving for a temporary restraining order under 18 U.S.C. § 1963(a) in connection with a crime involving RICO forfeiture and is not relevant to this case. Ex. A, Ltr. from Gov't dated October 26, 1989.

The memorandum from Assistant Attorney General Shirley D. Peterson sets Department of Justice policy concerning the use of mail fraud charges as RICO predicates where only the filing of false federal tax returns is involved. Authorization of the Tax Division is required before mail fraud counts are filed independently or as a predicate for RICO charges when the only mailing is a tax return or other IRS document or the charge is that the mailing was used to promote a federal tax fraud scheme. The memorandum states that federal tax offenses are not predicates for RICO charges and that such use could be viewed as an attempt to circumvent Congressional

intent. The Tax Division is to be consulted early for determination as to whether a mail fraud charge is to be based on the mailing of an IRS form or document. These memoranda had been the subject of several newspaper reports speculating about their implications. Ex. B, Ltr. from Gov't dated Oct. 26, 1989.

Defendants assert that "it is a fair inference that the new guidelines were prompted by this case," Ltr. on behalf of defendants dated Oct. 16, 1989 at 3, *id.* at 5-6, and that the guidelines articulate the defendants' position that "Congress did not intend to reach the kind of federal tax related conduct in this case." Contending that the government has not brought this kind of RICO case before and will not bring it again, defendants move for dismissal of the RICO counts.

Before receiving defendants' letter, newspaper reports of the memoranda had prompted the court to request the government to furnish it with copies of the reported memoranda and to give the court the government's view of the effect of the guidelines on its position concerning the validity of the RICO charges in this case and the right of the government to seek mandatory forfeiture of all defendants' interest in the enterprise including salary and management fees.

The government's position is straightforward: The Peterson memorandum has no application to this case because it was issued after commencement of the trial; and, additionally, both the original and superseding indictments had been reviewed and approved at a time when the policy expressed in the memoranda had been "formulated but had not yet [been] promulgated." It was pointed out that the guidelines provide for individualized determinations in each instance

which the government argues does not mean that proceedings similar to this case will not go forward in the future. Ltr. of Gov't dated Oct. 26, 1989.

This is not the only federal tax fraud indictment with mail or wire fraud violations brought as a RICO violation. *See United States v. Busher*, 817 F.2d 1409, 1412 (9th Cir.1987). The Peterson memorandum does not bar this or future tax fraud and mail fraud charges from being brought under the RICO statute. What is required is prior discussion with the Department of Justice personnel in Washington before the local prosecution may proceed. Such discussion took place in this instance. Accordingly, the motion is denied since I see no basis for dismissing the RICO counts on the strength of the Peterson memorandum.

II.

A.

The government moves for the court to rule that the jury was required to order total forfeiture of all the interests of the partner-defendants in PNP and all the salaries and management fees received from defendants from PNP.

The court is satisfied that the controlling law in the circuit left no discretion to the jury. Based on its findings, the jury was required to order forfeiture of the defendants' entire interest in the RICO enterprise. *United States v. Regan*, 858 F.2d 115, 119 (2d Cir.1988); *United States v. Porcelli*, 865 F.2d 1352, 1364-65 (2d Cir.), *cert. denied*, —— U.S. ——, 110 S.Ct. 53, 107 L.Ed.2d 22 (1989); *United States v. Walsh*, 700 F.2d 846, 857 (2d Cir.), *cert. denied*, 464 U.S. 825, 104 S.Ct. 96, 78 L.Ed.2d 102 (1983).

In accord, United States v. Kravitz, 738 F.2d 102, 104-05 (3d Cir.1984), *cert. denied*, 470 U.S. 1052, 105 S.Ct. 1752, 84 L.Ed.2d 816 (1985); *United States v. Hess*, 691 F.2d 188, 189-91 (4th Cir.1982); *United States v. Cauble*, 706 F.2d 1322, 1349 (5th Cir.1983), *cert. denied*, 465 U.S. 1005, 104 S.Ct. 996, 79 L.Ed.2d 229 (1984); *United States v. L'Hoste*, 609 F.2d 796, 809-14 (5th Cir.), *cert. denied*, 499 U.S. 833, 101 S.Ct. 104, 66 L.Ed.2d 39 (1980); *United States v. Busher, supra*, 817 F.2d at 1413; *United States v. Godoy*, 678 F.2d 84, 87-88 (9th Cir.1982), *cert. denied*, 464 U.S. 959, 104 S.Ct. 390, 78 L.Ed.2d 334 (1983); *United States v. Anderson*, 782 F.2d 908, 917-18 (11th Cir. 1968). I am also satisfied that such mandatory forfeiture was required of the salary and management fees of defendants Regan, Zarzecki, Rabinowitz, Berkman and Smotrich because it was clear from the jury verdict that these monies came from the enterprise it had found to be RICO tainted.

Indeed, except for the presence of Newberg, there would have been no need to have the jury determine the amount to be forfeited. Not having a partnership interest or salary or fees from the enterprise, any forfeiture required of Newberg had to be exacted pursuant to § 1963(a)(3), which amount the jury had to determine.

After pretrial hearings to determine the value of defendants' potentially forfeitable interests and assets to allow defendants to post a bond to secure the government interest in the event the defendants were found guilty on the merits of the requisite RICO violations, the court held that the partnership interests, and the salaries and management fees of the PNP partner-defendants were forfeitable, and that the sal-

aries of Smotrich and Newberg were subject to forfeiture. *United States v. Regan*, 699 F.Supp. 36, 38 (S.D.N.Y.1988) (Carter, J.). On October 21, 1988, an order was entered by the court that the reasonable value of the property subject to forfeiture was $14,011,323 representing the agreed upon value of the partner-defendants' interests in PNP and $3,611,573 representing the interest of Regan, Rabinowitz, Zarzecki, Berkman and Smotrich in other forfeitable property from the period July, 1984, to February 12, 1986.

After the return of the superseding indictment, the parties negotiated a new stipulation and order dated January 30, 1989, as to the value of potentially forfeitable property. The stipulation set the sum of $16,011,573 as the value of the partnership interests involved and $3,164,876 as potentially forfeitable salaries and management fees. The stipulation was so ordered by the court on January 31, 1989.

Accordingly, the amounts set forth in the stipulation constitute the agreed upon value of the interests, salaries and management fees of the PNP defendants subject to forfeiture. Regan's argument that half of his interest rightfully belongs to his wife cannot be credited. No mention was made to the court that Mrs. Regan shared in Regan's interest at the time the stipulation was so ordered on January 31, 1989. Pursuant to the October 21, 1988 order based on representations made by defendants and on a so ordered stipulation dated January 31, 1989, the amounts set forth therein must be accepted as accurate representations of the defendants' interest and fees.

Accordingly, based on its verdict, the jury was required to order forfeiture of $13,336,887 in part-

nership interest plus $1,759,975 in salary and management fees for Regan; $791,199 in partnership interest plus $454,507 in salary and management fees for Rabinowitz; $762,613 in partnership interest plus $558,328 in salary and management fees for Berkman; $1,120,874 in partnership interest plus $264,483 in salary and management fees for Zarzecki, and $124,583 in salary for Smotrich.

B.

That, however, does not end the matter. Forfeiture is limited by the Eighth Amendment prohibition against cruel and unusual punishment. *United States v. Walsh*, *supra*, 700 F.2d at 857 (forfeiture reaches all assets of the tainted enterprise except as limited by the 8th Amendment); *United States v. Huber*, 603 F.2d 387, 397 (2d Cir.1979), *cert. denied*, 445 U.S. 927, 100 S.Ct. 1312, 63 L.Ed.2d 759 (1980) (forfeiture is constitutional when "keyed to the magnitude of a defendant's criminal enterprise as it is in RICO"); *United States v. Horak*, 833 F.2d 1235, 1251 (7th Cir.1987) ("We are not insensitive to the concern of vast prosecutorial discretion in combination with potentially enormous forfeiture orders might in some circumstances threaten Eighth Amendment rights."); *United States v. Busher*, *supra*, 817 F.2d at 1413-16 (remand for forfeiture rehearing in light of Eighth Amendment concerns). What those limitations are has not been clearly established and there has been very little guidance given to trial courts in determining what yardsticks to apply to meet Eighth Amendment strictures in RICO forfeiture situations.

In *Solem v. Helm*, 463 U.S. 277, 103 S.Ct. 3001, 77 L.Ed.2d 637 (1983), the United States Supreme

Court held that the Eighth Amendment prohibits not only barbaric punishment but also those penalties disproportionate to the crime committed: "a court's proportionality analysis under the Eighth Amendment should be guided by objective criteria, including (i) the gravity of the offense and the harshness of the penalty; (ii) the sentence imposed on other criminals in the same jurisdiction; and (iii) the sentence imposed for the same crime in other jurisdictions." *Solem*, 463 U.S. at 292, 103 S.Ct. at 3010. These requirements can only be satisfied by a case-by-case assessment of the constitutionality of the particular punishment imposed. *See also, Weems v. United States*, 217 U.S. 349, 30 S.Ct. 544, 54 L.Ed. 793 (1910).

This circuit in *United States v. Lizza Industries, Inc.*, 775 F.2d 492 (2d Cir.1985), *cert. denied*, 475 U.S. 1082, 106 S.Ct. 1459, 89 L.Ed.2d 716 (1986), a case subsequent to *Solem*, endorsed application for forfeiture under 18 U.S.C. § 1963(a)(1) against an Eighth Amendment challenge even in a situation in which forfeiture reached profits defendants could have made irrespective of their illegal activities. The Court reasoned that to limit RICO forfeiture solely to a defendant's ill-gotten gains would frustrate Congress's goal in deterring criminal enterprises. *Id.* at 498-99. The provision in question, § 1963(a)(1), requires forfeiture of "any interest [a defendant] has accepted or maintained in violation of § 1962." The language here embraces "the proportionality analysis" set forth as the threshold requirement in *Solem*, although the *Lizza Industries* panel rejected its application in that case.

Under § 1963(a)(2), the provision applicable here, however, a defendant is required to forfeit 100 per-

cent of his interest in the illegal enterprise, even though some parts of the activities of the enterprise might be legitimate. The proportionality analysis comes into play in such cases only on application of the Eighth Amendment since 100 percent forfeiture in some cases might be such an excessive penalty as to exceed unconstitutionally the gravity of the offense. *United States v. Feldman*, 853 F.2d 648, 663 (9th Cir.1988), *cert. denied*, —— U.S. ——, 109 S.Ct. 1164, 103 L.Ed.2d 222 (1989) ("eighth amendment concerns may arise when a defendant must forfeit his or her entire interest in an otherwise legitimate business, even though only a few minor acts in the course of conducting the business were the predicate acts sufficient for a RICO violation").

The Second Circuit has recognized this possibility. *United States v. Porcelli*, *supra*, 865 F.2d at 1364 ("[t]he Eighth Amendment may limit the forfeiture where the enterprise is 'substantially engaged in legitimate business' ") (quoting *United States v. Walsh*, *supra*, 700 F.2d at 857); *United States v. Huber*, *supra*, 603 F.2d at 397 (district court intervention may be appropriate "where the forfeiture threatens disproportionately to reach untainted property of a defendant"). The Second Circuit, however, has yet to give shape and contour to Eighth Amendment restrictions applicable to § 1963(a)(2) forfeitures.

The Ninth Circuit has gone further than any other Circuit, as far as our research has been able to discover, in setting firm yardsticks to guide district courts in determining the specificity of Eighth Amendment constraints on § 1963(a)(2) forfeitures. Even though § 1963(a)(2) forfeiture is mandatory, "the district court must avoid unconstitutional results by

fashioning forfeiture orders that stay within constitutional bounds." *United States v. Busher*, *supra*, 817 F.2d at 1415. In applying *Solem*, judges are required to make specific findings regarding (1) the magnitude of the forfeiture, (2) the benefit attained by the defendant, (3) the defendant's state of mind and motive in committing the RICO violations, and (4) the degree to which the enterprise in question is tainted with criminal conduct. *Id.* The critical inquiry is whether "the interest ordered forfeited is . . . grossly disproportionate to the offense committed. . . ." *Id.* Under this analysis, legitimate businesses will not ordinarily be forfeitable in their entirety under § 1963(a)(2).

While it is concededly hazardous to venture into an area which has not yet been charted by our Court of Appeals, § 1963(a)(2) forfeiture raises acute Eighth Amendment concerns. Questions of fairness and equity must be faced, and even equal protection considerations lurk in the wings. Although I have rejected the defendants' claims concerning the Department of Justice's memoranda as a basis for dismissal of the RICO counts, for those defendants who were convicted only of crimes related to various forms of federal tax violations, these memoranda are relevant to the question of forfeiture. In these cases forfeiture of the defendants' entire partnership interests in PNP, plus salary and management fees seems so excessive as to breach Eighth Amendment constraints, if those constraints are to have any applicability to forfeiture.

Although our research has found no case that addressed the question of whether a RICO forfeiture is operative when the sole predicates are acts constituting a federal tax fraud, the Ninth Circuit in *United*

States v. Busher, supra, has unequivocally concluded that federal tax fraud activity may serve as the sole predicate for RICO violations. In *Busher*, however, the district court's order of forfeiture of the defendants' entire business was remanded for reconsideration in light of the Eighth Amendment pursuant to guidelines discussed above. There is no indication, however, that the Ninth Circuit intervened because the RICO predicate acts involved only federal tax fraud violations.

There are a number of cases in which it is unclear whether federal tax fraud activity was among the RICO predicate acts. In those cases while the defendants were convicted of federal tax fraud, they were also convicted of other offenses which alone could serve as necessary RICO predicates. *United States v. Bissell*, 866 F.2d 1343, 1348 n. 2 (11th Cir.), *cert. denied*, —— U.S. ——, 110 S.Ct. 146, 107 L.Ed.2d 104 (1989); *United States v. Aimone*, 715 F.2d 822, 824 (3d Cir.1983), *cert. denied*, 468 U.S. 1217, 104 S.Ct. 3586, 82 L.Ed.2d 883 (1984).

There are also cases in which defendants were charged under RICO for inducing investors to buy fraudulent tax shelters. *United States v. Eckhardt*, 843 F.2d 989 (7th Cir.), *cert. denied* —— U.S. ——, 109 S.Ct. 106, 102 L.Ed.2d 81 (1988) (criminal RICO); *Hofstetter v. Fletcher*, 860 F.2d 1079 (8th Cir.1988) (full text of opinion not published) (civil RICO); *United Energy Owners Committee, Inc. v. United States Energy Management Systems, Inc.*, 837 F.2d 356 (9th Cir.1988) (civil RICO). However, since the underlying offense in the above cases was in defrauding those induced to invest in the fraudulent schemes, they are not on point.

On the other hand, state tax fraud schemes have served as the sole predicate offenses for both criminal and civil RICO actions. *Illinois Dept. of Revenue v. Phillips*, 771 F.2d 312 (7th Cir.1985) (civil RICO action upheld against a retailer whose only offense was the filing of fraudulent state sales tax returns); *accord*, *Illinois ex rel. Hartigan v. Flisk*, 702 F.Supp. 189 (N.D.Ill.1988).

This Circuit in *U.S. v. Porcelli*, *supra*, has upheld a criminal RICO prosecution based solely on state sales tax fraud, an activity not criminalized under New York law. Although characterizing the case as pushing RICO "to its outer limits," the convictions were affirmed "by virtue of the extraordinarily broad sweep of RICO and of the federal mail fraud statute. . . ." *Id.* at 1355. The jury ordered forfeiture of $4,755,000 and 34 corporations. The Court of Appeals affirmed the forfeiture in large part but remanded to the lower court to determine the extent to which interest in untainted properties "would not have been acquired or maintained but for [the defendant's] fraudulent scheme." *Id.* at 1365. In addition, other properties were held forfeitable to the extent of contribution from the companies through which defendant maintained his fraudulent operation. *Id.* Previously in *United States v. Ianniello*, 621 F.Supp. 1455 (S.D.N.Y.1985) (Weinfield, J.), *aff'd*, 808 F.2d 184 (2d Cir.1986), *cert. denied sub nom. Cohen v. United States*, 483 U.S. 1006, 107 S.Ct. 3229, 97 L.Ed.2d 736 (1987), a RICO conviction was held based on state sales tax fraud, submitting fraudulent applications to the New York State Liquor Authority and bankruptcy fraud. Although federal income tax violations were charged, such violations do not appear to have served as a basis for the RICO claims.

Although, as the above discussion indicates, this area is not clear in this Circuit, the court is convinced that it has responsibility to fashion forfeiture orders in this case that lie within permissible constitutional constraints. Our research has uncovered no case in this jurisdiction in which a defendant was convicted solely of federal tax fraud infractions in which RICO forfeitures were ordered. Nor have we discovered such cases in other jurisdictions. Consideration of the Department of Justice's internal memoranda becomes relevant at this point, since it is safe to assume from these memoranda that the likelihood of future federal tax fraud cases being brought as RICO violations because the mails or wires have been used in connection with the tax fraud scheme is remote. Under these circumstances, to require Regan, Rabinowitz and Berkman to forfeit any assets would appear to be both unjust and unwarranted.

The government did not quantify during the trial the tax benefits which defendants obtained through their unlawful schemes. In their reply brief in support of its motion for mandatory forfeiture, the government has given estimates of the amount of taxes the defendants succeeded in avoiding paying pursuant to the tax parking devices. The government conceded that the actual benefits obtained by defendants were lower than the government's calculations, but the lower figure results from accounting adjustments, which the government suggests would not have been made if this indictment had not been filed. The government's figures are based on the unadjusted accounting methods pursuant to which it is calculated that Regan has permanently evaded the payment of $96,717 in 1986 federal income taxes and deferred $134,804 more of 1986 taxes to 1987-1990. Rabino-

witz has evaded permanently $4,291 in 1985 taxes and deferred $28,453 more in 1985 taxes to 1986-1990 returns. Zarzecki has permanently evaded $29,584 in 1985 taxes and deferred $35,596 more in 1985 taxes to 1987-1990 returns. Berkman has permanently evaded $129,725 in 1984 taxes and deferred $119,532 more in 1984 taxes to 1985-1987 returns.

These benefits to the defendants Regan, Rabinowitz and Berkman seem grossly disproportionate to the penalty total forfeiture would exact. In Regan's case, he would be required to forfeit some $15 million in assets for $96,717 of illegal tax benefits, Rabinowitz to forfeit $1.245 million in assets for $4.291 in illegal tax benefits and Berkman to forfeit $1.32 million in assets for $129,725 in illegal tax benefits. Smotrich received no tax benefits from the tax parking devices, and to require him to forfeit some $125,000 in salary seems also grossly out of line with his crime.

Accordingly, the court concludes that to require forfeiture of Regan's, Rabinowitz's and Berkman's partnership interests in PNP plus their salaries and management fees received therefrom and Smotrich's salary would appear to constitute cruel and unusual punishment within the meaning of the Eighth Amendment pursuant to *Solem's* yardsticks of disproportionality as to the offense itself, and as to the punishment imposed on similarly situated criminals in this and other jurisdictions. Thus the forfeiture of the assets of defendants Regan, Rabinowitz, Berkman and Smotrich is set aside.

Zarzecki and Newberg stand on a different footing. Both defendants were convicted not only of federal tax fraud and mail fraud in connection therewith, but also of securities fraud and wire fraud in

connection therewith. Moreover, while schemes to cheat the government of tax dollars are intolerable, schemes to manipulate and corrupt the nation's financial markets could undermine public confidence in the nation's financial institutions and, thereby, put the country's economic health at risk. I realize there was no evidence of market dislocation or any resultant investor harm, but what was attempted is egregious enough.

Unlike the federal tax fraud, the activities of Zarzecki and Newberg sought to victimize the investing public, rather than the government. The federal securities laws were designed to preserve the integrity of the country's financial markets and to protect them from the kind of manipulation Zarzecki and Newberg engaged in their effort to hold down COMB stock. Such illegal attempts to keep the ebb and flow of the market from responding to natural forces is a crime, regardless of how unsuccessful the outcome is in illegal gains for the perpetrator or how benign the results are for the potentially victimized investors. The Newberg-Zarzecki convictions for both federal tax fraud and securities fraud provide an appropriate basis for mandatory forfeiture of all of Zarzecki's partnership interest in PNP and all salary and management fees derived therefrom and for the § 1963(a)(3) forfeiture determined by the jury as to Newberg. These forfeitures are within the parameters deemed appropriate in other RICO convictions and do not offend Eighth Amendment proscriptions. Accordingly, forfeiture of Zarzecki's partnership interest in PNP of $1,120,874 and salary and fees of $267,483 is ordered; and forfeiture of $200,000 by Newberg, as found by the jury, is ordered effectuated.

III.

In sum, defendants' motions for acquittal or a new trial are denied. The government's motion that the jury was required to order a mandatory forfeiture of all the partnership interests of the partner-defendants in PNP, and the salaries and management fees received by defendants from PNP is granted. Forfeiture, however, is barred by the Eighth Amendment for defendants Regan, Rabinowitz, Berkman, and Smotrich. Full forfeiture is appropriate for defendant Zarzecki and forfeiture ordered by the jury of Newberg is undisturbed.

IT IS SO ORDERED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 2nd. day of October, one thousand nine hundred and ninety-one.

Docket Number (89-1591L)
89-1601
89-1614

UNITED STATES OF AMERICA, APPELLEE

v.

JAMES SUTTON REGAN, JACK Z. RABINOWITZ, CHARLES M. ZARZECKI, PAUL A. BERKMAN, STEVEN B. SMOTRICH, and BRUCE LEE NEWBERG, DEFENDANTS-APPELLANTS

[Filed Oct. 2, 1991]

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by

Appellants CHARLES M. ZARZECKI and BRUCE LEE NEWBERG

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/ Elaine B. Goldsmith
ELAINE B. GOLDSMITH
Clerk

APPENDIX D

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Docket Nos. 89-1591, 89-1592, 89-1600
to 89-1602 and 89-1614

UNITED STATES OF AMERICA, APPELLEE

v.

JAMES SUTTON REGAN, JACK Z. RABINOWITZ, STEVEN BARRY SMOTRICH, CHARLES M. ZARZECKI, PAUL A. BERKMAN, and BRUCE LEE NEWBERG, DEFENDANTS-APPELLANTS

Oct. 9, 1991

Before VAN GRAAFEILAND, MINER and MAHONEY, Circuit Judges.

ORDER AMENDING OPINION

On June 28, 1991 we filed a decision affirming in part and reversing in part judgments of conviction that followed a trial on a 64-count indictment in the Southern District of New York. As appears in our opinion, reported at 937 F.2d 823, we separated the plethora of counts into two groups which we labeled "THE TAX FRAUDS" and "THE SECURITIES FRAUD." For various reasons, we vacated the counts

in the tax frauds group but affirmed the counts in the securities fraud group. We also affirmed the conspiracy count whose allegations fell into both groupings.

Although appellants James Sutton Regan, Jack Z. Rabinowitz, Paul A. Berkman, and Steven Barry Smotrich did not argue in either their briefs or oral presentations in this court that they did not conspire to commit securities fraud, they now move to have their conspiracy convictions vacated. Because the participants in the trial below all appear to have assumed that these four defendants were not involved in the alleged securities fraud and there is little proof to justify a finding to the contrary, we conclude that the motion should be granted. The weakness in the Government's case concerning participation by these defendants in the securities fraud portion of the alleged conspiracy inclines us to the belief that the jury considered the conspiracy court against these four defendants only as it related to the alleged tax frauds. In any event, we are unable to state with certainty the true basis of the jury's general verdict against these four defendants on the conspiracy count. *See Zant v. Stephens*, 462 U.S. 862, 881, 103 S.Ct. 2733, 2745, 77 L.Ed.2d 235 (1983); *United States v. Garcia*, 907 F.2d 380, 381 (2d Cir.1990). Accordingly, our prior decision is amended to provide that the conviction of the four above-named defendants on the conspiracy count is vacated, and the issue of their guilt on this count is remanded for further proceedings.

In its response to the above motion, the Government pointed out that the court had made clerical errors with regard to the securities fraud counts on which Newberg and Zarzecki were convicted. The

errors apparently resulted from confusing the paragraph numbers with the count numbers in the lengthy and complicated indictment. Whatever the cause, they must be corrected. Both defendants were properly convicted on counts 48 to 53, and our prior decision therefore is amended to provide that the convictions of both Newberg and Zarzecki on counts 48 to 53 are affirmed.

(2)

No. 91-1233

FILED
MAY 4 1992
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1991

CHARLES M. ZARZECKI, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner's scheme to deceive an issuer and public investors about the market value of the issuer's securities by engaging in securities transactions for the purpose of depressing the market price constitutes unlawful manipulation under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

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In the Supreme Court of the United States

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 937 F.2d 823. An order amending that opinion (Pet. App. 52a-54a) is reported at 946 F.2d 188.

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1991. A petition for rehearing was denied on October 2, 1991. On December 9, 1991, Justice Thomas extended the time within which to file a petition for a writ of certiorari to January 30, 1992, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After a jury trial in the United States District Court for the Southern District of New York, petitioner was convicted on one count of conspiring to violate the tax and securities laws and to commit mail and wire fraud, in violation of 18 U.S.C. 371; one count of participating in the conduct of an enterprise through a pattern of racketeering activity, in violation of 18 U.S.C. 1962(c); one count of conspiring to commit that offense, in violation of 18 U.S.C. 1962(d); mail and wire fraud, in violation of 18 U.S.C. 1341 and 1343; two counts of securities fraud, in violation of 15 U.S.C. 78j(b) (Section 10(b) of the Securities Exchange Act of 1934) and 17 C.F.R. 240.10b-5 (Rule 10b-5 thereunder); and five counts of filing false partnership returns, in violation of 26 U.S.C. 7206(2). He was sentenced to three months' imprisonment, to be followed by two years' probation, and fined a total of $165,000. In addition, he was ordered to forfeit property. The court of appeals affirmed the convictions on the conspiracy count, four of the wire fraud counts, and the two securities fraud counts. It reversed the convictions on all the remaining counts. Pet. App. 1a-21a, 54a.

1. In March 1985, the firm of Drexel Burnham Lambert, Inc. (Drexel) was retained to underwrite a $25 million convertible bond offering for C.O.M.B. Co. (COMB), a company whose stock was traded in the over-the-counter market. Convertible bonds pay a fixed rate of interest and are convertible into common stock at a pre-determined price. The higher the market price of the stock when the bonds are offered, the more advantageous the bonds will appear from the standpoint of their convertibility into stock. The bonds can therefore be sold at a lower interest rate.

The lower the interest rate on the bonds, however, the harder it will be for the underwriter to market the bonds to investors who desire to earn interest income. Pet. App. 11a.

In connection with the COMB underwriting, Drexel scheduled a meeting with COMB for the evening of April 11, 1985, to price the bonds. One of the factors that would influence the bonds' pricing was the closing price of COMB's common stock on that day. Gov't C.A. Br. 36. Believing that COMB was "levitating" the price of its stock to a higher range in anticipation of the bond offering, Drexel devised a scheme to depress the price of COMB stock. Pet. App. 11a. Petitioner was a trader for the investment firm of Princeton Newport Partners. Shortly after noon on April 11, Drexel bond trader Bruce L. Newberg telephoned petitioner, told him about the COMB bond offering, and asked him to depress the price of COMB stock by selling it short.[1] Newberg also assured petitioner that he would be "indemnified" in that transaction.[2] Gov't C.A. Br. 36-37. Newberg stated:

> I want you to, you know, get rid of it, * * * I want it down to at least 15¾, and hopefully

---

[1] A short sale is a sale of stock that the seller does not own. At the time of the sale, the seller delivers borrowed stock; subsequently, the short seller must purchase stock to return the shares it previously borrowed. The short seller expects to profit from a decline in the price of the stock. See *United States* v. *Naftalin*, 441 U.S. 768, 770 (1979).

[2] Newberg was precluded from engaging in transactions in COMB stock for Drexel because that firm had put COMB securities on its "restricted list" in light of its role as underwriter of the bond offering. Gov't C.A. Br. 36. Restricted lists are commonly adopted to comply with the federal securities laws' prohibition against misuse of material nonpublic information.

> lower. Um, I wouldn't mind you selling a little bit first. And um, you're indemnified, * * * you know what I'm saying.

Id. at 37.

Petitioner immediately arranged to sell 10,000 shares of COMB stock to Jefferies & Co., a brokerage firm that made a market in COMB stock. When Jefferies' representative began asking questions about the transaction, petitioner became concerned. Rather than sell more COMB stock himself, petitioner asked a friend at another brokerage firm to sell COMB stock to Jefferies on petitioner's behalf, and to conceal petitioner's identity. Through that device, petitioner sold short 30,000 more COMB shares. Gov't C.A. Br. 37. Petitioner reported the subterfuge to Newberg, who remarked approvingly, "[w]elcome to the world of being a sleaze." *Id.* at 38. The price of COMB stock did not fall in response to petitioner's short sales, and he informed Newberg that he had failed to "dent them." *Ibid.* About an hour later, Newberg indicated that "if they take it up I want to hit 'em again." *Ibid.*

2. The jury was instructed to consider whether petitioner violated Section 10(b) and Rule 10b-5 through his short sales of COMB stock, and whether he committed wire fraud in connection with the same transactions. The trial court's instructions explained to the jury that the same scheme to defraud was involved in both the securities fraud and the wire fraud charges:

> The government contends that these sales [of COMB common stock] were executed in furtherance of a scheme to defraud COMB of money by driving the price of its common stock down, so that Drexel could obtain more favorable terms from COMB in its underwriting of an issue of COMB convertible bonds.

C.A. App. 4236 (wire fraud instructions); *id.* at 4235 ("the government charges * * * that [petitioner] and Mr. Newberg schemed to defraud COMB of money by manipulating the market price of its common stock"); *id.* at 4260-4261 (securities fraud instructions; court stated that "I've already explained to you the government's contentions regarding the fraudulent purpose of [petitioner's] sale of COMB common stock"). The court also instructed the jury that petitioner could be held liable for personally committing acts prohibited by Rule 10b-5, or for aiding and abetting such violations. C.A. App. 4262.

With respect to the elements of the Rule 10b-5 charge, the court instructed the jury to consider three categories of misconduct. C.A. App. 4262. First, the jury was to consider whether petitioner engaged in "[any] device, scheme or artifice to defraud," which is prohibited by Rule 10b-5(a). Second, the jury was to consider whether petitioner made "an untrue statement of a material fact" or omitted "a material fact necessary in order to make the statement not misleading," which is prohibited by Rule 10b-5(b). Third, the jury was to consider whether petitioner engaged in "any act, practice or course of conduct which would operate or did operate as a fraud or deceit upon any person," which is prohibited by Rule 10b-5(c). C.A. App. 4262-4263. On two of the securities fraud counts, the jury found that the government had proved that petitioner violated subsections (a) and (c) of Rule 10b-5, and that it had not proved that petitioner violated subsection (b) of that Rule. The jury also concluded that the government had established the other elements re-

quired for a violation of Rule 10b-5. C.A. App. 4350-27 to 4350-29.[3]

The district court denied petitioner's motion for acquittal. In recognition of the harm to public confidence caused by petitioner's "schemes to manipulate and corrupt the nation's financial markets," the court also ordered forfeiture of petitioner's partnership assets in Princeton Newport. Pet. App. 48a. The court noted that "[t]he federal securities laws were designed to preserve the integrity of the country's financial markets and to protect them from the kind of manipulation [petitioner] and Newberg engaged in their effort to hold down [the price of] COMB stock." *Ibid.*

3. On appeal, petitioner relied on *Chiarella* v. *United States*, 445 U.S. 222 (1980), in arguing that the jury instructions erroneously permitted him to be convicted for nondisclosure to the purchasers of the manipulated securities, when he had no legal duty to make any disclosure because he was not a fiduciary of those purchasers. The court of appeals rejected that claim, holding that petitioner's participation in a scheme to use "devious means to depress the price" of COMB stock constituted a violation of Section 10(b) and Rule 10b-5. The court explained that petitioner's scheme operated to deceive the marketplace about the pricing of publicly traded stock, and fit within the "full range of ingenious devices that might be used to manipulate securities prices." Pet.

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[3] Petitioner was also convicted on the related wire fraud counts. See C.A. App. 309-310 (Indict. Counts 48-51, charging violations of the wire fraud statute); C.A. App. 4350-26 to 4350-27 (jury verdict finding petitioner guilty on Counts 48-51). The jury acquitted petitioner on one count of securities fraud that charged an additional sale of COMB securities. C.A. App. 4350-30.

App. 12a, quoting *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 477 (1977). The court of appeals found that *Chiarella* v. *United States*, *supra*, which considered disclosure duties in the insider trading context, is not applicable in the case of a market manipulation scheme. Pet. App. 13a.

ARGUMENT

Petitioner contends that his participation in a scheme to manipulate the price of COMB's common stock was not a crime, and that the court of appeals' affirmance of his conviction conflicts with decisions of this Court. The decision below, however, is correct, is consistent with the decisions of this Court, and does not conflict with any decision of another court of appeals. Review by this Court is therefore not warranted.

1. Petitioner asserts that he committed no crime because he "merely sold stock" with a "hope" that his trading would lower the market price of COMB securities. Pet. 15. That is an erroneous description of what petitioner did. Petitioner sold COMB stock in furtherance of Drexel's scheme to perpetrate a fraud on COMB. Drexel's goal was to obtain more favorable terms in COMB's bond offering; to achieve that end, Drexel had petitioner enter the market in the guise of a legitimate and independent seller of COMB stock. Pet. App. 12a. Petitioner himself took no market risk in these transactions because Drexel had "indemnified" him. He simply engaged in short sales designed to lower the market price of COMB's stock, while giving the market the misleading impression that he was engaging in bona fide transactions. The court of appeals properly found that this conduct fell within the range of "ingenious devices" that Con-

gress meant to prohibit under Section 10(b) of the Exchange Act. Pet. App. 12a, quoting *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 477 (1977).[4]

Petitioner's contention (Pet. 11-14, 19-21) that his conviction is inconsistent with this Court's decisions in *Chiarella* v. *United States*, 445 U.S. 222 (1980), and *Schreiber* v. *Burlington Northern, Inc.*, 472 U.S. 1 (1985), is incorrect. Petitioner suggests (Pet. 11-12) that he was convicted only of nondisclosure in this case because the jury did not find that he made "an untrue statement of a material fact or omitted to state a material fact necessary to make facts stated not misleading" in violation of Rule 10b-5(b); he then argues that under *Chiarella*, a nondisclosure conviction cannot stand absent proof of a breach of a fiduciary duty. The conviction in this case, however, rests on petitioner's "false and fictitious acts" of manipulation, *Schreiber*, 472 U.S. at 7 n.4 (quoting *Scott* v. *Brown, Doering, McNab & Co.*, [1892] 2 Q.B. 724, 730), which the jury concluded amounted to a "device, scheme or artifice to defraud" and "an act, practice or course of business that operated, or would operate, as a fraud or deceit upon a purchaser or seller of COMB common stock," in violation of Rule 10b-5(a) and (c). See C.A. App. 4350-27 to 4350-29. Those provisions are not limited to fraud by nondisclosure; "they are flat prohibitions

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[4] Petitioner was also convicted of wire fraud, but the question presented by the petition does not separately challenge those convictions. Pet. (I). Nor does petitioner cite any authority for his claim (Pet. 3) that his wire fraud convictions must fall if he did not commit securities fraud. Cf. *Carpenter* v. *United States*, 484 U.S. 19, 24 (1987) (affirming mail and wire fraud convictions unanimously, but affirming securities fraud convictions growing out of the same scheme by an evenly divided Court).

of deceitful practices and market manipulations." *United States* v. *Charnay*, 537 F.2d 341, 350 (9th Cir.), cert. denied, 429 U.S. 1000 (1976).[5]

By engaging in the conduct for which he was convicted, petitioner acted to deceive COMB, persons trading in COMB stock, and offerees of COMB convertible bonds about the market value of COMB stock. His trades were designed to give the false appearance that the COMB stock price was falling because of bona fide trading activity, an appearance that would not have existed in the free interplay of supply and demand. See *Santa Fe Indus., Inc.*, 430 U.S. at 476 (manipulation includes "rigged prices, that are intended to mislead investors by *artificially* affecting market activity") (emphasis added). Petitioner's concealment of his identity, of the fact that he was acting for Drexel, and of Drexel's agreement to indemnify him for any losses he suffered is probative of his purpose to deceive COMB and the investing public. See *In re Grand Jury Subpoena Duces Tecum Dated September 15, 1983*, 731 F.2d 1032, 1041 (2d Cir. 1984) (noting that use of dummies or fictitious parties is a common sign of fraud). Deception of the

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[5] In *Charnay*, the court of appeals affirmed the defendant's conviction for manipulating security prices without requiring a showing of a breach of a fiduciary duty. 537 F.2d at 349-350. Petitioner acknowledges (Pet. 17 n.7) that *Charnay* supports the decision in this case, but simply claims that in light of later decisions of this Court, it is not "valid authority." No decision of this Court, however, suggests that a market manipulation scheme is lawful unless the defendant also commits fraud by breaching a fiduciary duty. Rather, the Court has recognized that "manipulation" includes "practices, such as wash sales, matched orders, *or rigged prices*, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. at 476 (emphasis added).

public and COMB as to the true nature of his transactions, and of Drexel's behind-the-scenes role in those transactions, was essential for petitioner's scheme to work.

It has long been recognized that stock trades made without verbal misrepresentations, but executed solely for the purpose of raising the stock price, can be fraudulent. See *Scott* v. *Brown, Doering, McNab & Co.*, *supra* (broker who bought shares for the sole purpose of causing trading on the exchange at a premium defrauded the public through false acts).[6] Petitioner was convicted for such affirmative acts of deception. Unlike in *Chiarella*, in which a trader simply remained silent about material information concerning a stock's value when engaging in securities transactions,[7] or in *Schreiber*, in which all material facts associated with a tender offer were fully disclosed,[8] petitioner engaged in affirmative conduct designed to deceive investors by creating an artificial

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[6] In *Schreiber* v. *Burlington Northern, Inc.*, *supra*, this Court quoted with approval the statement of Lord Lopes in *Scott* that "I can see no substantial distinction between false rumours and false and fictitious acts." 472 U.S. at 7 n.4, quoting [1892] 2 Q.B. at 730.

[7] In *Chiarella*, the Court held that a financial printer who deduced the names of takeover targets from documents submitted to his print shop and then purchased stock in those companies had not violated Rule 10b-5 by trading without disclosure to the sellers. The Court held that disclosure in that instance is not required absent a "duty to disclose arising from a relationship of trust and confidence between parties to a transaction." 445 U.S. at 230.

[8] In *Schreiber*, the Court held that an acquiring company's revision of the terms of its tender offer did not constitute a violation of Section 14(e) of the Exchange Act, 15 U.S.C. 78n(e), when there was no allegation of misrepresentation, nondisclosure, or deception. 472 U.S. at 1.

market price for COMB stock. The duty to refrain from such affirmatively deceptive conduct does not depend on whether the defendant has a fiduciary relationship to investors in the market. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 (1976) (defining manipulation as "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of a security").[9]

2. Petitioner suggests that the court of appeals approved a "radical new theory" that criminalizes a trade solely on the basis of the trader's purpose. Pet. 10 n.3. There is, however, nothing novel about the theory underlying petitioner's conviction. The courts of appeals that have addressed such manipulative schemes have uniformly concluded that trades made to affect security prices violate Rule 10b-5. See *Pagel, Inc.* v. *SEC*, 803 F.2d 942, 945-946 (8th Cir. 1986); *Alabama Farm Bureau Mutual Casualty Co.* v. *American Fidelity Life Ins. Co.*, 606 F.2d 602, 611-613 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980); *United States* v. *Charnay*, 537 F.2d at 347-351; *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 379 (2d Cir. 1974), cert. denied, 421 U.S. 976

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[9] Petitioner also errs in his alternative claim that, even if he had a duty to make disclosure, it would not extend to his "subjective motivation" for selling stock. Pet. 18-19, citing *Virginia Bankshares, Inc.* v. *Sandberg*, 111 S. Ct. 2749, 2760 (1991) ("disbelief or undisclosed motivation, standing alone, [is] insufficient to satisfy the element of fact" under the proxy antifraud provisions). *Virginia Bankshares* held that a board of directors' statement of reasons for recommending a transaction in a proxy solicitation could not be challenged as fraudulent solely on the ground that the directors may not have believed the reasons they gave. That holding is perfectly consistent with the holding here that security trades constitute unlawful manipulation when made for the purpose of affecting market prices.

(1975); see also *Landy* v. *FDIC*, 486 F.2d 139, 161 (3d Cir. 1973) ("scheme deliberately calculated to manipulate the market value of a stock" is covered by Rule 10b-5), cert. denied, 416 U.S. 960 (1974); *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 793 (2d Cir. 1969) (scheme in which company "painted the tape" with trades solely to manipulate market price violated Rule 10b-5), cert. denied, 400 U.S. 822 (1970). Moreover, short-selling schemes similar to petitioner's have long been the subject of civil enforcement actions brought by the Securities and Exchange Commission, see *Delafield & Delafield*, [1967-69 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,648 (1968), as well as criminal prosecutions, see *United States* v. *Charnay*, *supra*; *United States* v. *Lewis*, [1989 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 94,479 (S.D.N.Y. 1989).

Petitioner brushes aside (Pet. 17 n.7) that law by suggesting that the defendants in most of those cases, unlike petitioner, were underwriters or corporate officers with a duty to disclose their manipulative trades. The defendants in *Charnay* and *Crane*, however, were not such persons, and none of the cases suggests that the existence of a fiduciary duty is required to establish liability. Rather, the cases are premised on the view that manipulative trading subverts the integrity of the market. As the SEC has explained, Rule 10b-5 bans trades made for the purpose of manipulating stock prices because their effect "is to distort the character of the market as a reflection of the combined judgments of buyers and sellers, and to make of it a stage-managed performance." *Halsey, Stuart & Co.*, 30 S.E.C. 106, 112 (1949). In any event, since petitioner was acting on behalf of and conspiring with Drexel—an underwriter who, as petitioner concedes (Pet. 4), has a duty to both "the

issuer and the investing public"—petitioner's conduct would be a crime even under his view of these cases.

The elimination of manipulative schemes was one of the central goals of the federal securities laws. In passing the Exchange Act, Congress intended "to insure the maintenance of fair and honest markets" in securities transactions. 15 U.S.C. 78b(3). Because Congress concluded that "[f]requently the prices of securities on [securities] exchanges and [over-the-counter] markets are susceptible to manipulation and control," 15 U.S.C. 78b(3), it prohibited trading activity aimed at deceiving investors about the state of the market for a security. Among the express targets of the Exchange Act were the so-called "pools," groups who engaged in trades for the general purpose of affecting security prices. See S. Rep. No. 1455, 73d Cong., 2d Sess. 30-32 (1934); Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. Miami L. Rev. 671, 691-697 (1986). The committee reports accompanying the Exchange Act noted that such trading interfered with market prices "established by the free and honest balancing of investment demand with investment supply." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 10 (1934); S. Rep. No. 1455, *supra*, at 81.

Section 10(b), in particular, was designed to proscribe all intentional conduct designed to deceive investors, including schemes to affect stock prices "beyond the operation of normal market factors." *Alabama Farm Bureau*, 606 F.2d at 611. "Deceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injury to investors at which the [Exchange] Act and the Rule [10b-5] were aimed." *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 547 (2d Cir. 1967). Con-

gress understood that the hallmark of manipulation is the perpetrator's purpose. A trade made to affect the market price or induce other trades is manipulative; a trade made merely with the knowledge that it will have an impact on the market price is not. H.R. Rep. No. 1383, *supra*, at 20.[10]

Petitioner argues (Pet. 22-23) that a trade made to affect the market price of a security is lawful so long as it is an actual and not a fictitious trade. The express language of the Exchange Act, however, demonstrates that Congress intended to prohibit actual trading designed to rig market prices. Section 9(a)(2) makes it unlawful to engage in "a series of transactions in any [listed] security * * * creating *actual* or apparent active trading in such security or raising or depressing [its] price * * * for the purpose of inducing the purchase or sale of such securit[ies] by others." 15 U.S.C. 78i(a)(2) (emphasis added); see *United States* v. *Projansky*, 465 F.2d 123 (2d Cir.) (upholding conviction under Section 9(a)(2) for conspiring to raise securities price through actual trading), cert. denied, 409 U.S. 1006 (1972).[11] The

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[10] Commentators at the time understood that Congress intended to prohibit trades undertaken for the purpose of affecting market price. See Comment, *Market Manipulation and the Securities Exchange Act*, 46 Yale L.J. 624, 634 (1937); Berle, *Stock Market Manipulation*, 38 Colum. L. Rev. 393, 405-406 (1938); Note, *Regulation of Stock Market Manipulation*, 56 Yale L.J. 509, 519-520 (1947). Modern commentators agree. See L. Loss & J. Seligman, *Securities Regulation* 3939, 3954-3983 (3d ed. 1991); Poser, *supra*, 40 U. Miami L. Rev. at 699-700; Thel, *Regulation of Manipulation Under Section 10(b); Security Prices and the Text of the Securities Exchange Act of 1934*, 1988 Colum. Bus. L. Rev. 359, 376.

[11] Section 9 applies to securities traded on exchanges and not to over-the-counter stocks such as COMB. For an example

ban of manipulative devices in Section 10(b) was intended to include the practices listed in Section 9, see *SEC* v. *Resch-Cassin & Co.*, 362 F. Supp. 964, 975 (S.D.N.Y. 1973), although it is not limited to them, see *Charnay*, 537 F.2d at 350-351 (Rule 10b-5 bans manipulative trades irrespective of whether Section 9(a)(2)'s requirement of purpose to induce others to trade is present).

Petitioner also suggests (Pet. 22-24) that market manipulation cannot yield profits to wrongdoers unless they make subsequent trades at manipulated prices, that petitioner did not do so, and that he therefore has been convicted of a "victimless crime." Petitioner's tampering with the market's pricing mechanism, however, undermined the market's integrity for all participants, regardless of whether he sought to exploit that advantage through later trading. In any event, the manipulative scheme devised by Drexel and executed by petitioner directly victimized COMB. The government's contention at trial, which the jury accepted, was that Drexel had petitioner sell COMB stock in the over-the-counter market, while indemnifying him against loss, in order to lower COMB's stock price and thereby obtain more favorable terms from COMB in the underwriting negotiations. C.A. App. 4236, 4687-4694. Such a scheme is a far cry from the "victimless" conduct in which petitioner claims he engaged.[12]

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of a short-selling scheme similar to petitioner's that was found to violate both Rule 10b-5 and Section 9(a)(2), see *J.A.B. Securities Co.*, 47 S.E.C. 86, 91-92 (1979).

[12] Petitioner suggests that his manipulation was "socially *beneficial*" and a "public *service*" (Pet. 27, 28) because his purported goal was to counteract COMB's perceived levitation of the price of its stock. There is, however, no safe harbor in

3. Finally, petitioner suggests that the Second Circuit's holding will lead to undesirable consequences for innocent market participants. First, petitioner suggests (Pet. 25-26) that using a trader's purpose to determine the lawfulness of his transactions is dangerous because the line between proper and improper purpose cannot easily be ascertained. Courts, however, are experienced in distinguishing between trades made for investment or other nonmanipulative purposes, see *Chris-Craft Indus., Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir.), cert. denied, 414 U.S. 910 (1973); *United States* v. *Mulheren*, 938 F.2d 364, 369 (2d Cir. 1991), and trades made solely to manipulate the price of a security, see *Charnay*, 537 F.2d at 346 n.5. It is a commonplace in the criminal law that whether the defendant's actions are unlawful turns on his purpose and intent. See, *e.g.*, *Morissette* v. *United States*, 342 U.S. 246, 250-252 (1952). The record in this case, in which petitioner's taped conversations starkly reveal the origins and purpose of his manipulative scheme, refutes petitioner's fears that he was exposed to the "unfair risk of criminal punishment" (Pet. 25).[13]

Rule 10b-5 for manipulations (or other fraudulent devices) undertaken as a self-help remedy for perceived illegal conduct by others. See *Edward J. Mawod & Co.*, 46 S.E.C. 865, 872 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979).

[13] Petitioner understandably relies on hypotheticals to illustrate the risk of unfairness, such as the investor who on "whimsy" seeks to raise the stock price to "honor" his daughter's birthday, or a "wealthy eccentric" who wishes to punish a company whose products he dislikes by driving down its stock price. Pet. 26. Even if petitioner were correct in assuming that such transactions are lawful because investors "put their own money at risk in arm's-length transactions in order to serve noneconomic goals" (Pet. 27), petitioner did

Petitioner also urges that it is bad economics to criminalize trades made for the purpose of manipulating securities prices (Pet. 27), and that he was convicted only because his transactions "do not conform to some economists' conception of why people buy and sell securities" (Pet. 10). He relies on a law review article that argues that there is no evidence that manipulative trades actually affect security prices and that enforcement efforts are too costly. See Fischel & Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 Harv. L. Rev. 503 (1991). The authors of that article admit, however, that " '[t]rading with bad intent' does provide the term 'manipulation' with unique meaning, and such trading may be undesirable if manipulations do affect securities prices." *Id.* at 553.[14] In enacting Sections 9 and 10(b), Congress expressed the view that such trading *is* undesirable. Disagreement with the policy of those provisions should be addressed to Congress, not to the federal courts.

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not do so. Petitioner engaged in an artificial transaction at Drexel's behest in which he was "indemnified" against loss, in order for Drexel to achieve the economic goal of defrauding COMB.

[14] The cases brought against market manipulators demonstrate that many have succeeded. See L. Loss & J. Seligman, *supra*, at 3984-3985 (describing wave of recent market manipulations).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

CHARLES M. ZARZECKI, PETITIONER

v.

UNITED STATES OF AMERICA, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF FOR THE PETITIONER

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1. A principal thrust of the government's effort to avoid this Court's review of the rule adopted by the court of appeals is to suggest that petitioner was subject to being validly convicted on other grounds, on which the court of appeals did not rely. That tack is untenable. When multiple theories of a single offense are submitted to a jury, a resulting conviction cannot stand if *any one* of those theories is *legally* unsound. *Griffin* v. *United States*, 112 S. Ct. 466, 474 (1991) ("[w]hen * * * jurors have been left the option of relying upon a legally inadequate theory, there is no reason to think that their own intelligence and expertise will save them from that error"); *Yates* v. *United States*, 354 U.S. 298, 312 (1957). Thus, as the Solicitor General himself advised this Court in *Griffin*: "[W]hen a judge incorrectly instructs the jury as to the law, and therefore creates a significant

risk that a jury might have convicted the defendant based on conduct that is not a crime, the defendant is entitled to a new trial." U.S. Br. 20, No. 90-6352.

In this case, the jury was allowed to convict petitioner if it believed that his *actual, arm's-length* trades were engaged in with the intent to affect the price of COMB stock, even if he had no fiduciary duty to anyone. The government defended that theory—and *only* that theory—in the court of appeals. See Appendix, *infra*. The court of appeals accepted it as its *sole* basis for affirming all of petitioner's convictions for securities fraud, wire fraud, and conspiracy. Pet. App. 12a-13a.[1] The government defends that holding in this court (*e.g.*, Br. in Opp. 11 & n.9, 14, 16-17), but, as we showed in the petition and further substantiate below, that holding cannot be reconciled with this Court's decisions.

The government's alternative theories on which the conviction could be upheld include its arguments that

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[1] We note, in this regard, that the government apparently hopes to save its wire fraud convictions even if this Court reverses the securities fraud convictions. Br. in Opp. 8 n.4. The court of appeals, however, affirmed the wire fraud convictions *solely* on the ground that petitioner committed securities fraud (Pet. App. 11a-13a), without a word of discussion of petitioner's related challenges to his wire fraud convictions (C.A. Br. 20-22; C.A. Reply Br. 6-10). Granting that there are *some cases* in which wire fraud convictions may stand while securities fraud convictions fall, as the government contends, this is not one of them. Rather, when the different types of fraud convictions are closely related, the Second Circuit will vacate mail or wire fraud convictions if the securities fraud convictions are invalid. See *United States* v. *Chestman*, 947 F.2d 551, 571 (2d Cir. 1991) (en banc), cert. denied, 60 U.S.L.W. 3735 (U.S. April 27, 1992) (No. 91-1085).

petitioner's trades were fictitious because he was "indemnified" by Drexel (Br. in Opp. 3, 7, 15, 16-17 n.13) and that petitioner did owe a fiduciary duty of some sort to COMB that he breached by not disclosing some unspecified fact (*id.* at 4-5, 7, 9, 15). Those theories—advanced in this Court although not relied on by the government in the court of appeals—are irrelevant because they were at best alternative bases for conviction offered to the jury at trial, theories that the jury may well have rejected on the facts while accepting the government's defective legal theory that actual trades made with "bad intent" are criminal without more.[2] All that is properly before

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[2] The government's recitation of the facts in this Court is at best a slanted one that assumes—incorrectly in light of the multiple theories submitted to the jury—that the jury must have resolved *all* factual disputes in the government's favor. For example, the government insists in this Court (although it did not argue below) that the use of the word "indemnified" in one of the taped conversations meant that Drexel would cover any losses that petitioner sustained by trading in COMB stock. In fact, in context, what the word meant was that petitioner—following Princeton Newport's longstanding trading strategy—would be allowed to buy sufficient convertible bonds at the public offering to cover his short position in COMB stock. Tr. 3758. In a transparent effort to manipulate the facts to fit its sinister interpretation of them, the government's statement completely ignores the fact that Princeton Newport *did* purchase bonds to cover its short position as soon as they became available in the public offering, as it always did. See Pet. 4-5, 6. The government likewise omits mention of the fact that petitioner's trading had *no effect* on the price of COMB stock. To describe petitioner's trades as "designed to give the false appearance that the COMB stock price was falling because of bona fide trading activity" (Br. in Opp. 9) is at best hyperbole, since the price of COMB stock was *not* falling and the government is assuming its legal conclusion in asserting that petitioner's trading activity was not bona fide.

this Court is the question decided by the court of appeals and raised in the petition. On that point, the government's defense of the court of appeals' holding is flatly wrong.

2. After a careful review of the cases and commentary on stock market manipulation, a commentator wrote in 1988 that "the law neither requires traders to disclose their motivations nor makes it illegal to trade for the purpose of changing prices." Thel, *Regulation of Manipulation Under Section 10(b): Securities Prices and the Text of the Securities Exchange Act of 1934*, 1988 COLUM. BUS. L. REV. 359, 420; see also Berle, *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264, 272 (1931) (common law did not prohibit arranging trades for the purpose of influencing price). The government nevertheless comes to this Court and asks it to accept as established law the directly contrary propositions that "trades made to affect security prices violate Rule 10b-5" without more (Br. in Opp. 11), that "security trades constitute unlawful manipulation when made for the purpose of affecting market prices" without more (*id.* at 11 n.9), and that "[a] trade made to affect the market price or induce other trades is manipulative" without more (*id.* at 14). Supposedly in support of the latter proposition, the government cites the very article by Professor Thel that flatly *contradicts* its proposition. *Id.* at 14 n.10.[3] Something is very wrong here. What is wrong is the government's adamant refusal to recognize the necessary im-

[3] The government cites a page (1988 COLUM. BUS. REV. at 376) that does not support the proposition for which it is cited and that, in any event, reflects criticism of some of this Court's decisions rather than an assessment of what those decisions mean. The passage we have quoted, by contrast, is a black-letter statement of existing law.

pact of this Court's decisions, particularly *Schreiber* v. *Burlington Northern, Inc.*, 472 U.S. 1 (1985), on its theory of manipulation-by-intent.

It is a measure of the weakness of the government's position that it embraces with open arms the theory that it is crime to use a broker for the purpose of concealing the identity of the principal in a securities transaction. Br. in Opp. 9-10 (equating use of a broker with "use of dummies or fictitious parties"); *id.* at 4 (characterizing as a "subterfuge" petitioner's use of a broker, which the government concedes was the only basis for the "sleaze" comment). If that is a crime, then a great deal of trading activity that goes on in America is criminal. The government's theory is not limited to some narrow class of cases in which use of a broker violates some discernible *duty* to disclose the trader's identity, for petitioner—who was neither a fiduciary nor an insider—was under no duty (see *Chiarella* v. *United States*, 445 U.S. 222, 228-229 (1980)) to disclose *anything*.[4] In the absence of such

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[4] Thus, in the court of appeals, the government emphasized that it was *not* pursuing an insider trading theory (Gov't C.A. Br. 137) and adamantly defended the trial court's refusal to instruct the jury that it could find liability only if it found a breach of a fiduciary duty (*id.* at 135-138). The court of appeals likewise disclaimed any reliance on a "fiduciary relationship" in this case. Pet. App. 13a. In this Court, by contrast, the government has invented the entirely new theory that petitioner *did* have disclosure duties because he "was acting on behalf of and conspiring with Drexel." Br. in Opp. 12. But, of course, a conviction may not be affirmed on the basis of a theory not presented to the jury. *Chiarella*, 445 U.S. at 236. So that this Court can fully understand the degree to which the government has espoused in this Court theories that contradict its position in the court of appeals, we reprint as an appendix to this brief the *entire* discussion of securities fraud from the Argument section of the government's brief in the court of appeals.

a duty, it is perfectly legitimate for a trader who believes that his financial interest is furthered by nondisclosure of his identity to use a broker. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 405 ("the SEC * * * presumably * * * cannot require [traders] to reveal their identities").

Furthermore, the government has simply ignored the fact (see Pet. 21) that, had petitioner *not* used a broker and instead dealt with Jefferies directly, the only possible effect would have been to drive the price *lower*, thus furthering the alleged "scheme." The government asserts that "[d]eception of the public and COMB * * * was essential for petitioner's scheme to work" (Br. in Opp. 9-10), but it offers no clue as to how dealing with Jefferies directly (as petitioner *did* in one of the transactions on which his convictions rest) or telling *Jefferies* of Drexel's role would have resulted in greater disclosures to the public or COMB. The government's theory is illogical on the facts of this case. More important, the government's position has such far-reaching implications that it itself enhances the importance of review by this Court.

Equally telling is the government's response to our demonstration that, after *Chiarella* and *Schreiber*, "manipulation" cases require either a misrepresentation or a breach of a duty to disclose a specific fact. The government expressly denies "that the existence of a fiduciary duty is required to establish liability" (Br. in Opp. 12), but, like the court of appeals, never comes to grips with what we have shown (Pet. 11-14) to be the clear import of *Chiarella*, *Schreiber*, and the many commentaries reading those cases as we read them.[5] Rather, the government cites only two deci-

[5] The government attempts (at 10 & nn.7-8) to confine those cases to their facts, without even dealing with the

sions of courts of appeals, both decided *before* the pertinent decisions of this Court. One of those older decisions (*Charnay*) cannot survive this Court's subsequent rulings (see Pet. 16-17 & n.7), while the other does not support the government's position because it involved misrepresentations in the form of public purchases coupled with simultaneous secret sales at lower prices. *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 792-798 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970).

Here, there were no undisclosed transactions to counterbalance the disclosed transactions and make their apparent import misleading. Rather, there were only public trades that the government admits would be legal (and not deceptive) if made with "good" intent but seeks to condemn (and label as "deceitful") because it regards them as having been made with "bad intent" (Br. in Opp. 16-17). Furthermore, petitioner cannot be swept within *Crane*'s misrepresentation theory because he was *acquitted* of making "untrue statement[s]" (17 C.F.R. § 240.10b-5(b)), a fact that the government acknowledges (Br. in Opp. 5) but then tries to dismiss in an incomprehensible passage (*id.* at 8) that accuses petitioner of the precise transgression of which he was acquitted. See *ibid.* (accusing petitioner of " 'false and fictitious acts' of manipulation" because he was convicted under the subsections of Rule 10b-5 that deal with fraudulent conduct *other than* expressing falsehoods and fictions); see also *id.* at 10-11 (accusing peti-

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broader principle of *Chiarella* that trading in silence (such as petitioner's) cannot be condemned as "deception" and the broader principle of *Schreiber* that "deception" is required before fraud by manipulation can be found.

tioner, based on trading alone, of "affirmative acts of deception" and "affirmative conduct designed to deceive investors by creating an artificial market price for COMB stock").[6]

Ultimately, the government's legal discussion is nothing more or less than a plea—with citations to pre-*Schreiber* cases, the legislative history of Section 9(a)(2) of the Securities Exchange Act of 1934,[7] and

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[6] The government's brief uses many pejorative labels. *E.g.*, Br. in Opp. I ("scheme to deceive an issuer and public investors"), 3 ("scheme to depress the price of COMB stock"), 4 ("device" and "subterfuge" consisting of selling through a broker), 7 ("scheme to manipulate the price of COMB's stock"), 10-11 ("conduct designed to deceive investors by creating an artificial market price"), 12 ("manipulative trading"), 16 n.12 ("self-help remedy for perceived illegal conduct by others"). What is consistently absent, however, is reasoning to justify the use of those labels. For example, the government describes petitioner's conduct as having "rigged prices." Br. in Opp. 9 & n.5 (emphasis omitted). As the name suggests, however, "rigged prices" are those that result from collusive activity between a buyer and a seller such that the true consideration paid for a stock differs from the price apparent to the public. Here, however, petitioner and Jefferies undeniably were trading at arm's length, with an actual exchange of consideration at the bargained price.

[7] The government is completely out of line when it contends in this Court (Br. in Opp. 14-15) that petitioner violated Section 9(a)(2), 15 U.S.C. § 78i(a)(2). It elected to charge this case under Section 10(b) and Rule 10b-5 *instead of* Section 9(a)(2), for the obvious reason that petitioner did *not* violate Section 9(a)(2) because he did not act "for the purpose of inducing the purchase or sale of such securities by others," as that section requires. See generally Pet. 22-24. The government also treats it as established law, although it cites only a single 16-year-old Ninth Circuit decision, that Section 10(b) is a broader prohibition of manipulative practices than Section 9(a)(2). Br. in Opp. 15. In fact, there is

commentators—to hold either that criminal "manipulation" under the securities laws does not require deception or that trading with "bad intent" can be shoehorned within the term "deception." This requires either a direct rejection of the unequivocal teaching of *Schreiber* that "manipulation" requires "deception," or a backdoor undermining of *Schreiber* by labeling mere trades as affirmative acts of deception based on nothing more than the intent of the trader. See Thel, *supra*, 1988 COLUM. BUS. L. REV. at 437 ("if the word deceptive is construed to include disruptive trading, it is being given a much broader construction than the Court, or for that matter almost anyone else, has given it"); see also *id.* at 428.

If the principle laid down so clearly in *Schreiber* is now to be overturned, however, that should be done only after full briefing and argument, and in any event not in a criminal case to which the rule of lenity applies. See generally *United States* v. *R.L.C.*, 112 S. Ct. 1329, 1338 & n.6 (1992) (plurality opinion); *id.* at 1339-1341 (Scalia, J., concurring in the judgment); *id.* at 1341-1342 (Thomas, J., concurring in the judgment). It would be unconscionable to deny certiorari and let a criminal conviction stand just because the government can make an argument suggesting—contrary to *Schreiber*—that "bad intent" provides all the deception necessary in a "manipulation" case based on actual trades.

All of the government's efforts to avoid the issue in this case—either by advancing arguments that were

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a split of authority on that question, with at least one court (see Pet. 22-23 n.12) holding that Section 10(b) is narrower than Section 9(a)(2) in manipulation cases and prohibits *only* that which Section 9(a)(2) prohibits.

not the basis of the holding below or by obfuscating about the meaning of this Court's decisions—should be rejected. This is a *criminal* securities fraud case in which liability cannot properly be premised on tenuous theories drawn from cases that are outdated (see Pet. 17 n.7) or easily distinguishable (see *id.* at 14-15 n.6, 17 n.7). While unfairly heaping opprobrium on petitioner throughout its brief in opposition, the government does not bother to deny (see Br. in Opp. 16-17 & n.13) that its theories would render many innocent activities criminal. See Pet. 25-29. This Court should not let that happen.

For the foregoing reasons and those given in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1992

APPENDIX

APPENDIX

Excerpt from Brief for the United States of America, *United States* v. *Regan*, No. 89-1591 (2d Cir.)

[135] **D. The Jury Was Not Required To Find That Newburg And Zarzecki Breached a Duty Arising From A Relationship of Trust And Confidence.**

Newberg and Zarzecki contend that Judge Carter erred in refusing to instruct the jury that an omission is fraudulent under Rule 10b-5 only if the defendant breached a duty "toward a person with whom the defendant has a relationship which would cause that person to place trust and confidence in the defendant." (A. 911). In the defendants' view, they cannot be guilty of manipulation under Rule 10b-5 because they had no "general duty of disclosure." (Z/N Br. 16). In a similar vein, they also contend that their wire fraud convictions arising out of the COMB manipulation cannot stand because Judge Carter "failed to state that material non-disclosures are fraudulent only when there is a duty to disclose." (Z/N Br. 21). Neither claim has merit.

The first of those contentions evinces a profound misunderstanding of the governing law. Newberg and Zarzecki were prosecuted under Rule 10b-5 on a theory of manipulation. The term " 'refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.' " *Schreiber* v. *Burlington Northern*, [136] *Inc.*, 472 U.S. 1, 6 (1985) (quoting *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 476-77 (1977)). *See also Ernst &*

Ernst v. *Hochfelder*, 425 U.S. 185, 199 (1976) (manipulation "connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities"); *Field* v. *Trump*, 850 F.2d 938, 946-47 (2d Cir.), *cert. denied*, 109 S. Ct. 1122 (1988).

It is well settled that persons who engage in such artificial and misleading practices commit a fraud on the public just as surely as if they affirmatively disseminated false statements in the market place. *See, e.g.*, *Schreiber* v. *Burlington Northern, Inc.*, *supra*, 472 U.S. at 7 n.4 (noting that deception can be effected not only with "false rumours" but also with "false and fictitious acts"); *In the Matter of Pagel, Inc.*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,909, at 87,752 (1985), *aff'd sub nom. Pagel, Inc.* v. *Securities and Exchange Comm'n*, 803 F.2d 842 (8th Cir. 1986). Not surprisingly, it has long been the law that such manipulative practices *themselves* give rise to liability, absent disclosure of the manipulation to the entire market. *See, e.g.*, *Thornton* v. *Securities and Exchange Comm'n*, 171 F.2d 702, 703 (2d Cir. 1948) (*per curiam*) (finding that defendant engaged in matched orders and wash sales "leads of course to the affirmance of the Commission's further findings that [defendant] willfully violated §§ 10(b) and 15(c) . . . in selling these stocks . . . at prices based on the exchange quotations without disclosure of its manipulation of the exchange market"); *United States* v. *Charnay*, 537 F.2d 341, 351 (9th Cir.) ("Failure to disclose that market prices are being artificially depressed operates as a deceit on the market place and is an omission of a material fact"), *cert. denied*, 429 U.S. 1000 (1976); 3 L. Loss, *Securities Regulation* 1561 (2d ed. 1961)

("when securities are in fact sold at manipulated prices without disclosure of the manipulation, it has been repeatedly held both by the Commission and by the courts that there is a violation of the anti- [137] fraud provisions"). Because the defendants were charged with manipulation, Judge Carter correctly refused to give the "fiduciary duty" instruction they requested.

Chiarella v. *United States*, 445 U.S. 222 (1980), on which the defendants rely, did not require Judge Carter to give a "fiduciary duty" instruction in this case. The fiduciary concept announced in *Chiarella* and its progeny, *see, e.g., Dirks* v. *Securities and Exchange Comm'n*, 463 U.S. 646 (1983), is relevant to cases where the defendant is accused of trading on the basis of material nonpublic information, and has no applicability where, as here, the gravamen of the charge is market manipulation. Because there was no evidence at all in this case concerning allegations of insider trading, no instruction on fiduciary duties was required. *See, e.g., United States* v. *Durrani*, 835 F.2d 410, 419-20 (2d Cir. 1987) ("A judge is required to charge on a defense theory only if the evidence provides some foundation for it").

The defendants' reliance on *Schreiber* v. *Burlington Northern, Inc., supra*, is even less apt. While they correctly note *Schreiber*'s holding that there can be no manipulation when all the relevant facts are disclosed, *Schreiber* v. *Burlington Northern, Inc., supra*, 472 U.S. at 7-8, this holding cannot possibly help them because they admit, as they must, that they disclosed nothing. In any event, defendants fail to explain how *Schreiber* can reasonably be read as compelling an instruction on an insider trading theory that was not

pressed by the Government or otherwise supported by any evidence.

The defendants' second claim—that Judge Carter erred in not charging that a wire fraud conviction may be grounded on an omission only if there is a duty to disclose—fares no better. Defendants' failure to request that "duty to disclose" charge (A. 896-904) "defeats their claim on appeal that such an instruction was required" absent plain error, which they wisely do not claim. *United States* v. *Keplinger*, 776 F.2d 678, 698 n.9 (7th Cir. 1985) (in mail fraud case, failure to request instruc- [138] tion requiring the jury to find a special relationship before it can find a duty to disclose is a waiver), *cert. denied*, 476 U.S. 1183 (1986). Furthermore, that claim was independently waived by the defendants' failure to object to the charge on that specific ground before the jury retired to consider its verdict. *See* Fed. R. Crim. P. 30; *United States* v. *Civelli*, *supra*, 833 F.2d at 194; *United States* v. *Friedman*, *supra*, 854 F.2d at 555-56.*

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* To the extent Newberg and Zarzecki now claim that their "fiduciary duty" request under Rule 10b-5 was also intended to apply to the wire fraud counts relating to the same conduct—a proposition belied by the record—the legal error of such an instruction in the wire fraud context is demonstrated by the very authorities they cite. *See United States* v. *Dowling*, 739 F.2d 1445, 1449 (9th Cir. 1984) ("We decline to adopt the 'fiduciary duty' limitation advanced by Dowling . . ."), *rev'd on other grounds*, 473 U.S. 207 (1985). Thus, it would not have been error to decline to charge the jury on fiduciary duties even if defendants had specifically and unambiguously requested such an instruction. *See, e.g.*, *United States* v. *Ouimette*, *supra*, 798 F.2d at 49.